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The Underlying Values of German and English Contract Law

By

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A thesis submitted in partial fulfilment of the requirements of a Doctor of Philosophy
(Ph.D.) degree in Law.

University of Warwick, Department of Law

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Declaration

I confirm that the thesis is my own work. I also confirm that the thesis has not been submitted for a degree at another university.

Abstract

This thesis identifies the underlying values of German and English contract law. It establishes that to some extent almost all values are reflected in both jurisdictions but that in many cases the underlying values compete with each other. The thesis identifies the balance of the values in the context of four problem areas namely pre-contractual duties of disclosure (breaking off negotiations), mistake, unfair contract terms and changed circumstances. The thesis concludes that although almost all values are reflected in each system the balance of the values differs significantly. This is important and topical because identifying the balance of the competing values within a jurisdiction and contrasting these to another jurisdiction provides a deeper level of understanding of the courts' decision-making process. The particular questions which the research addresses are twofold, firstly, which values are competing within the context of a particular problem, and secondly, what weight is given to each value in a given context in contrast to the other jurisdiction.

In order to address these questions a combination of doctrinal and comparative research methods is adopted. The focus is on the decisions of the respective courts', but doctrinal elements are also explored through the way in which cases were interpreted by academic writers at that particular time, while a functional comparative method is adopted. The work does not aim to create its own theory of contract or try to engage in the theoretical debate of which universal values 'should' apply.

The implications of the research findings are that policies at a European level can more accurately identify the core underlying values if they firstly identify the viability of harmonising areas of contract law and at a national level and evaluate potential legislative changes in light of these values. Additionally, identification of the values also allows further research on the desirability of the values to be conducted.

Chapter 1 – Introduction and Methodology

The main aim of this research is to compare four areas of German and English law on the basis of how each jurisdiction balances underlying values with regard to several problems that can broadly be characterised as pre-contractual duties of disclosure, mistake, unfair contract terms and change of circumstances. The comparison will show that although both systems functionally have the capability to achieve the same result (and for the most part do so), the underlying values may differ even when the same result is achieved or alternatively the competing values may be accorded different weighting, leading to a different outcome.

The introduction to this thesis will first of all set out the assumptions that must be made in order to begin creating the theoretical framework within which this thesis belongs. It will then establish the hypothesis of this research and explain why the research is original. A short literature review will follow which in part will interlink with the methodological framework of the thesis. Finally this chapter will explain the limitations (i.e. what the thesis will not do) and provide the reader with a brief summary of the remaining chapters.

1.01 Framework of the thesis

This thesis is built on two basic assumptions. These are, firstly, that German and English contract law are aiming to perform more or less the same functions and, secondly, that the systems are underpinned by values and that those values influence the legislative and juristic decision-making process, and so affect how the same ends are achieved.

The first assumption is that both systems will use different concepts and terminology in order to deal with a particular problem but that in most cases the result will be the same.¹ It will be shown, and the volume of comparative literature provides testament to this, that in the areas considered there is a great deal in common (at the very least at a macro level).²

The second hypothesis that the thesis proposes is that values underlie the decisions of judges. Assuming that the rules and regulations have their origin in some value judgment by the legislator it would seem like the system is built on values. This would encompass for example the efficient exchange of goods as a basic value. The assumption is that judges in individual instances are influenced by values and that the influence of these values brings about a divergence in the final outcome or a convergence in cases where the basic rules in a particular system point to a result that the judges seem to feel is manifestly unjust so that they develop the law in order to achieve a result that aligns with their reasoning.

An example of diverging end results may be the famous pre-contractual duties of disclosure (Chapter 3) where in the German cases there is a general duty of disclosure (though there are restrictions) and in English law there is not. The German emphasis (we will see) is on the protection of the invested trust in the

¹ Zweigert and Kötz, *Introduction to Comparative Law* (3rd edn, Oxford University Press 1998) p. 34-35; Michaels, 'The Functional Method of Comparative Law' in Reimann & Zimmermann (ed), *The Oxford Handbook of Comparative Law* (Oxford University Press 2006), p. 364-366.; Samuel, *An Introduction to Comparative Law Theory and Method* (Hart Publishing 2014) p. 12;

² See below the discussion on the economic theory. See Ch. 1.03

relationship (and other values) but the English courts are firmly protecting the freedom of contract and the principle of caveat emptor. However, the convergence becomes clearer in the case where the English courts will use for example the law of joint venture to create a result that reflect the German result. Protection of freedom of contract is limited where the court accepts that there is an objective relationship of trust.

In order for this thesis therefore to accomplish its aim it must first assume that the values exist (a matter that is fairly uncontroversial seeing as most people would accept that they are influenced by some sort of values) and for that reason it is believed that it is generally accepted that the law is also underpinned³ by moral, religious, philosophical values.⁴

³ Kennedy, *A Law Unto Themselves* (29 July 2014) <<http://www.bbc.co.uk/programmes/b04bnd0l>> accessed 26 September 2015 where Justice Michael Kirby (Australian High Court judge) remarks that judges are undoubtedly influenced by their values; Worthington, 'Common Law Values: The Role of Party Autonomy in Private Law' in A. Robertson and M. Tilbury (eds), *The Common Law of Obligations: Divergence and Unity* (Chapter 14, Hart Publishing) (2015); Campbell, 'Good Faith and the Ubiquity of the 'Relational' Contract' (2014) 77 *The Modern Law Review* 475 Adams and Brownsword, 'The ideologies of contract' (1987) 7 *Legal Studies* 205; Brownsword, 'The Law of contract: Doctrinal Impulses, External Pressures, Future Directions' (2014) 31 *Journal of Contract law* 73; Dari-Mattiacci and Guerriero, 'Law and Culture: A Theory of Comparative Variation in Bona Fide Purchase Rules' (2015) 1 *Oxford Journal of Legal Studies* 1.

⁴ Even though they seem to be mentioned repeatedly without necessarily providing clear guidance on what the values may be and how they operate (or in fact where they come from), just that they exist and influence the law making process (e.g. Zimmermann, 'Characteristic Aspects of German

1.02 Hypothesis

This thesis sets out to confirm the hypothesis that although German and English contract law have functionally equivalent mechanisms to deal with a given problem and that will (at least at a macro level) achieve similar results, different (or a different weighting of) values underpin the two systems which may lead to opposing results. The functional approach⁵ will be used to analyse how the two systems approach four different categories of contract law problems and will allow a comparison of the legal outcomes to those problems which will assist in unearthing the underlying values.

This thesis derives its originality from three elements: firstly, the approach to the comparison of German and English contract law; secondly, by identifying the values that underpin the courts' decisions in both systems; and, thirdly, by showing how these values interact in different situations.

1.03 Where does it fit in?

From a comparative theoretical framework the thesis will use the functional equivalence as the basis for comparison.⁶ The thesis thereby relies on the work of

Legal Culture' in J. Zetkoll and M. Reimann (eds), *Introduction to German Law* (Kluwer Law International 2005), p. 22.

⁵ The functional approach was selected on the basis that it is the most appropriate approach for comparative research, see Samuel, *An Introduction to Comparative Law Theory and Method* (Hart Publishing 2014), p.19-20.

⁶ Zweigert and Koetz, *Introduction to Comparative Law* (3rd edn, Oxford University Press 1998) p.33-47.

Legrand⁷, Watson⁸ and Teubner⁹ to justify the actual comparison of the two systems. It does so based on the discussion of cultural values being the framework of the quest for whether or not legal transplants can be effective. In all cases the authors have relied on the existence of values and the basis of their work is that values continue to exist that either make it impossible¹⁰ or possible to transplant.¹¹ This thesis will therefore build on the idea that these values exist by relying on the same method but will not go on to question whether this implies that they can be transplanted or not.

As comparative law matures¹² and the fundamental knowledge of the legal systems grow there is an increase in the will to understand why another jurisdiction has

⁷ Legrand, 'The Impossibility of 'Legal Transplants'' (1997) 4 Maastricht Journal of European and Comparative Law 111.

⁸ Watson, *Legal transplants : an approach to comparative law* (Edinburgh : Scottish Academic Press 1974).

⁹ Teubner, 'Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergencies' (1998) 61 The Modern Law Review.

¹⁰ i.e. the discussion between Legrand and Watson. (e.g. see Watt, 'Comparison as deep appreciation' in P.G. Monateri (ed), *Methods of Comparative Law* (Edward Elgar Publishing Ltd. 2012).

¹¹ See Teubner who argues that the transplant will irritate the system in a positive way and will then (if not rejected) be accepted to become part of the value framework.

¹² The previous immaturity is evidenced by the rise in books published recently on comparative methodology and theory (e.g. Samuel, *An Introduction to Comparative Law Theory and Method* (Hart Publishing 2014); Adams and Bomhoff (eds), *Practice and Theory in Comparative Law*

chosen a particular approach. This explains why in the last few years there has been a rise in literature/debate on 'why' a legal system functions in the way that it does.¹³ The starting point for any literature review must be Markesinis (et al.) 'The German Law of Contract'¹⁴ and Beale (et al.) 'Ius commune Case book'¹⁵. The main focus for Markesinis is to explain the German law of contract to an English audience and by comparing it to some of the English cases. The methodology is similar to that of this thesis in that it uses functionalism as the basis for comparison. It is a result-orientated comparison. However, this approach, though in some cases explaining the doctrinal basis (and possibly the history of that doctrine), does not focus on values or the relationship of values. The cases are therefore chosen on the basis of

(Cambridge University Press 2012); Siems, *Comparative Law* (William Twining, Christopher McCrudden and Bronwen Morgan eds, Cambridge University Press 2014)).

¹³ For example: Beale, *Mistake and non-disclosure of fact : models for English contract law* (Oxford University Press 2012); Beale and others, *Contract Law: Ius Commune Casebooks for Common Law of Europe* (2nd edn, Hart Publishing 2010); Dari-Mattiacci and Guerriero, 'Law and Culture: A Theory of Comparative Variation in Bona Fide Purchase Rules' (2015) 1 Oxford Journal of Legal Studies 1; Collins, 'Implied Terms: The Foundation in Good Faith and Fair Dealing' (2014) 67 Current Legal Problems 297; Gullifer and Vogenauer, *English and European perspectives on contract and commercial law : essays in honour of Hugh Beale* (Hart Publishing 2015); Bant and Bryan, 'Fact, Future and Fiction: Risk and Reasonable Reliance in Estoppel' (2015) Oxford Journal of Legal Studies 1; Rowan, *Remedies for breach of contract: A comparative analysis of the protection of performance* (Oxford University Press 2012).

¹⁴ Markesinis, Unberath and Johnston, *The German Law of Contract: A Comparative Treatise* (2nd edn, Hart Publishing 2006).

¹⁵ Beale and others, *Contract Law: Ius Commune Casebooks for Common Law of Europe* (2nd edn, Hart Publishing 2010).

how best to exemplify the particular legal phenomenon or doctrine. In contrast this thesis has chosen the cases based on their ability to exemplify the values underlying a particular doctrine and the development of those values over time. It also determines the origins of those values. The 'Ius Commune case book'¹⁶ similarly sets out how the relevant jurisdictions achieve similar results. However, as the book is mainly aimed at providing an understanding of the law of contract in different jurisdictions it is at the same time not focusing on 'why' the result is achieved but on 'how' the result is achieved. The closest explanation from a value-analysis can be found in Hugh Beale's work on mistake and non-disclosure of facts.¹⁷ The focus of the research there is on whether or not it would be desirable for English law to follow a similar approach to German law and it therefore extracts the relevant competing values. The question of whether the values are desirable is something that this thesis will avoid addressing mainly on the ground that it could distort the explanation of the values itself. However, the approach to identifying the values is similar and is built on in this thesis.

There are then expositions of German law which rely solely on the explanation of the system. Zekoll and Reimann provide an introduction to German law and of particular interest is Zimmermann's chapter on the legal culture in Germany.¹⁸

¹⁶ Ibid.

¹⁷ Beale, *Mistake and non-disclosure of fact : models for English contract law* (Oxford University Press 2012).

¹⁸ Zimmermann, 'Characteristic Aspects of German Legal Culture' in Mathias Reimann and Joachim Zekoll (eds), *Introduction to German Law* (Kluwer Law International 2005).

However, in contrast to this thesis the discussion centres on the explanation of the German system without the comparative aspect. The focus in both the aforementioned books is on understanding the doctrinal and theoretical basis of the legal system and not the underlying values. For example the explanation of the German culture crosses several areas of law without thereby focussing on particular values or the comparison of those values. It therefore poses the question of 'why' the system is the way it is from a historical rather than a 'value' point of view.¹⁹

The question of underlying values in English law has been ongoing but has resurfaced as a central topic quite recently. Adams and Brownsword divide the courts' decisions (or in fact the legal system) between formalism, realism, market individualism and consumer welfarism.²⁰ Each category contains sub-categories for example a market-individualist (realist)²¹ approach which may or may not become apparent when applying a (for example) formalist approach because a formalist approach in itself would lead to the same conclusion.²² Adams and Brownsword at no point argue (and neither does this thesis) that this idea of market individualism and consumer welfarism are entrenched systems of thoughts in some judges but

¹⁹ E.g. Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (Clarendon Press 1996).

²⁰ Adams and Brownsword, 'The ideologies of contract' (1987) 7 Legal Studies 205.

²¹ For example they describe Lord Wilberforce as a market-individualist, realist for his decision in *Gibson v Manchester City Council* [1974] 1 All ER 972.

²² Adams and Brownsword, 'The ideologies of contract' (1987) 7 Legal Studies 205, p.219.

that there will be some attempt to evaluate the direction in which each legal systems tends.

To add to that is the argument put forward by Collins that the system of law is self-referencing and closed.²³ In other words it favours those that know what information may or may not be excluded from an examination of the case.

However, the argument made here is that within certain doctrines (and this is exemplified best in contrast to a different legal system) judges/ legislators are influenced by more specific values and/or understanding of values. The example in Chapter 4, looking at German law, is that of the *Daktari Film Case*²⁴ where the friendship of the parties (though Collins²⁵ argues this is excluded from consideration in English law) forms the basis of a duty to disclose information. This is in contrast to English law where only if one could define the relationship as one of joint venture could any such duty exist.²⁶ There it would seem the definition of 'good business' differs and understanding is neither derived from a consumer-welfarist/market individualist thinking (though it may lead to the categorisation later) but from the underlying values that form the understanding of what is in fact just. In other words, the categorisation as consumer-welfarist is a consequence of the underlying values and not the cause.²⁷ This means that this thesis aligns with the

²³ Collins, *Regulating Contracts* (Oxford University Press 2002), p. 41.

²⁴ BGH MDR 1979, 730 (*Daktari Film Case*) .

²⁵ Collins, *Regulating Contracts* (Oxford University Press 2002), p. 1-7.

²⁶ See the argument of this thesis in Ch. 3.07.

²⁷ Of course once the judges has identified with one of the schools of thought this may influence the values.

argument of Adams and Brownsword as a causal link between the macro identification and the micro influences. It thereby also supports the arguments put forward by Collins²⁸ that formalism is on the decline but it adds to the argument of why this is the case.

In all the work of the aforementioned scholars the main focus has been to find an overarching system (or value systems) within which the whole of contract law will fit. The argument put forward in this thesis is that the values in play in a particular case differ depending on the legal problem. These values may well fit into the consumer-welfarist or market-individualist category but they provide a more detailed explanation of the outcome. This view, it is argued, can only be achieved through the comparison between legal systems. This is not to say though that the values identified (e.g. reasonable expectations of honest men) might not still fit within either the consumer-welfarist or market-individualist category, as the conclusion will show.

More recently Sarah Worthington has picked up on the debate on values.²⁹ She discusses in her chapter how far the English courts still protect party autonomy.³⁰ Party autonomy is identified as one of the key values in this thesis. The difference is

²⁸ Collins, *Regulating Contracts* (Oxford University Press 2002), p. 41.

²⁹ Worthington, 'Common Law Values: The Role of Party Autonomy in Private Law' in Robertson and Tilbury (eds), *The Common Law of Obligations: Divergence and Unity* (Chapter 14, Hart Publishing 2015).

³⁰ Ibid.

that this thesis will analyse more than one value and will explain the competition between those values.

1.04 Methodology

Zweigert and Koetz propose that more often than not the same practical results are achieved in different jurisdictions by using different legal rules.³¹ For this reason the thesis starts with a national legal doctrine (e.g. the law of mistake) and develops several factual variations. It will, for the most part, leave aside the cases that are dealt with in similar ways and will focus on those cases where the outcome is different. This is not to say that the thesis will ignore the method by which the legal system achieves the result, in fact the way in which the result is achieved (e.g. by using 'good faith' or 'culpa in contrahendo') will provide evidence of the particular values on which the courts are relying.

The aim is not to show how differences of legal structure³² can lead jurists to arrive at different conclusions with respect to the facts of cases³³ but rather to show how the values that underlie the legal method affect the outcome and how these may also lead to different conceptual structures.

³¹ Zweigert and Koetz, *Introduction to Comparative Law* (3rd edn, Oxford University Press 1998), p. 36-40.

³² The example used by Samuel, *The Foundations of Legal Reasoning* (Maklu Uitgevers 1994), p. 76-79 is that of *Read v J Lyons & Co* [1974] AC 156 and *Dunne v North Western Gas Board* [1964] 2 QB 806.

³³ G. Samuel, *An Introduction to Comparative Law Theory and Method* (2014) Hart Publishing, p. 17-18.

The convergence and divergence of the approach on common problems can be a source of lessons and solutions in the most basic format but it is the explanation of the underlying reasons of the court that sets the thesis apart from other descriptions of the law of these countries.³⁴

The thesis subscribes to the method of functionality³⁵ that aims to look at the outcome the legal system aims to achieve by whatever method may seem appropriate.³⁶ There is no need to justify that '*like Hamlet, [it is possible for us] to tell a hawk from a handsaw, and to do so without a complete theory of aerial predators or an exhaustive inventory of the carpenter's toolbox*'.³⁷ The reason is that the argument that the anti-thesis (i.e. that there is no need for a theoretical framework because it is common sense) itself is the thesis of comparative method, needs neither to be confirmed nor allayed³⁸ because this thesis uses the method of structural (functional) comparison and the justification for this approach is providing a deeper understanding of the law.

³⁴ This is described as the value contribution to the field of comparative law in Rowan, *Remedies for breach of contract: A comparative analysis of the protection of performance* (Oxford University Press 2012), p. 1.

³⁵ K. Zweigert and H. Koetz, *An Introduction to comparative Law (3rd Edition)* (1998) Clarendon Press: Oxford, p. 34.

³⁶ For a similar methodology see S. Rowan '*Remedies for breach of contract: A comparative analysis of the protection of performance*' (2012) Oxford University Press, p. 3.

³⁷ Weir, 'Contracts in Rome and England' (1992) 66 Tulane Law Review 1615, 1616.

³⁸ G. Samuel, *An Introduction to Comparative Law Theory and Method* (2014) Hart Publishing, p.19-20.

In conclusion this thesis is based on doctrinal research with the theory of functional equivalence as the methodological framework.

1.05 Limitations

Since this thesis not only looks beyond the English jurisdiction but also beyond individual concepts of contract law there are certain limitations and it is accordingly important to set out what this thesis will not do. One could argue that because the thesis is based on functional equivalents, different concepts could be transplanted. However, this thesis will keep a firm lid on the existing debate between Pierre Legrand and Alan Watson (and their respective followers)³⁹ by not entering the debate on legal transplants and/or the cultural value system that may surround the legal construct.⁴⁰ With Pandora's (or Legrand/Watson's) box firmly closed, the focus will be on the cultural values that have been expressed within either the academic literature and have been reflected in the case law or discussion papers leading to legislative change. The thesis will not address whether these values add to the debate on the ability to transplant legal constructs.

³⁹ Watt, 'Comparison as deep appreciation' in Monateri (ed), *Methods of Comparative Law* (Edward Elgar Publishing Ltd. 2012), p. 82-85.

⁴⁰ Legrand, 'The Impossibility of 'Legal Transplants'' (1997) 4 *Maastricht Journal of European and Comparative Law* 111, 111; see also Watson, *Legal transplants : an approach to comparative law* (Edinburgh : Scottish Academic Press) 10; Smits, 'The Harmonisation of Private Law in Europe: Some Insights from Evolutionary Theory' (2002) 31 *Georgia Journal of International and Comparative Law*, p. 79-99.

There will also be no attempt to evaluate the 'appropriateness' of the values or to engage with the theoretical framework of the values in any wider philosophical debate. The purpose of this thesis is to set out the philosophical/cultural/moral underpinnings of specific contractual doctrines which have been chosen on the basis of their divergence in approach and in some cases outcome. However, in some cases it may be unavoidable to comment on whether the particular value is appropriately integrated into the system (or by evaluating the historic development of the value, establish that it was not but now is sufficiently protected).

A key methodological issue for this thesis is how to identify the values and there must therefore be a limitation placed on the definition of a value. This partly connects with the methodology explained above, namely that the thesis, by using the doctrinal research method, thereby is limited to the expression, which may include an implied expression, of these values by the legislator or the courts (or a reflection of secondary literature that the court/legislator relied on). It means therefore that there may well be other moral/philosophical underlying values but these will only be taken into account in so far as they are expressed or clearly implicit. The reason for this limitation lies in the fact that only articulated values (or values that are implicit but clearly visible) can contribute to the evolution of the legal doctrine.

1.06 The values

There may be cases that allow the judges to tilt the law and/or make decisions on the direction of the law. For example in cases such as *Baird Textiles*⁴¹ it is assumed that the courts were making a decision on whether to tilt the law either towards competition or cooperation. The end result was to follow the overall theme of competition. The thesis will attempt to look deeper at what values the judges were actually looking to protect. In this case the basic values has to be that of freedom of contract (and with that probably the protection of the individual autonomy). What is particularly interesting for this thesis is where these values have come from and how they relate to each other in different scenarios. The final conclusion will therefore be that there are occasional variations in values but the main difference is in fact the weight given to each value in relation to the other competing values.⁴² With that in mind, the thesis will also show that in some cases there is a different understanding of what a particular value⁴³ (e.g. reasonable expectations) or concept may mean (e.g. fraud).⁴⁴ The important feature of the thesis is that it will aim to

⁴¹ *Baird Textile Holdings Ltd v Marks & Spencer Plc* [2001] CLC 999.

⁴² See particularly chapter 3 and 4.

⁴³ There may even be some controversy within the legal system itself.

⁴⁴ The long term nature and the commitment to contracts is characterised in for example the principle of culpa in contrahendo being suggested by Medicus to protect parties against unwelcome contracts with a right to revoke them if they were caught off guard see Zimmermann, 'Consumer Contract Law and General Contract Law: The German Experience' (2005) *Current Legal Problems*, at 475; or in English law what the meaning of 'reasonable expectations' may actually mean and whether that is the foundation of contract law, see Brownsword, *Contract Law: Themes for the twenty-first*

frame the values in precise terms rather than finding overarching categorisations (e.g. paternalism, consumer-welfarism).⁴⁵

The values that this thesis has identified in the two legal systems are protection of the will of the parties, protection of party autonomy,⁴⁶ invested trust (either in the other party or in the venture), *pacta sunt servanda* (i.e. the contract is binding), equivalence and also nominalism, *clausula rebus sic stantibus* (i.e. the assumption that circumstances will remain the same), protection of society,⁴⁷ protection against unfair gain, risk allocation (whether contractual or by the legislator), protection against informational imbalance, protection of the legislative body, protection of the parties' contractual relationship, and the reasonable expectations of honest men. The chapters will show which values compete in particular scenarios.⁴⁸

century (Oxford University Press 2006); Collins, 'Implied Terms: The Foundation in Good Faith and Fair Dealing' (2014) 67 *Current Legal Problems* 297; Collins, *The European Civil Code* (Cambridge University Press, 2008), p.26; cf. Fried, *Contract as a promise a theory of contractual obligations* (Harvard University Press 1981), p. 74.

⁴⁵ E.g. Nathan Oman has theorised that private law is underpinned by 'honour' (Oman, 'The Honor of Private Law' (2011) 80 *Fordham Law Review* 31) or Sarah Worthington begins with the assumption that the overall battle in English law is over paternalism and autonomy in Worthington, 'Common Law Values: The Role of Party Autonomy in Private Law' ' in Robertson and Tilbury (eds), *The Common Law of Obligations: Divergence and Unity* (Chapter 14, Hart Publishing 2015) p. 1.

⁴⁶ Here there are several meanings attached for example this could go to the parties consent but also could be framed in the German terms of self-determination.

⁴⁷ Suffice it to say here that there are several meanings that could be attached to this value.

⁴⁸ For an overview see the conclusion.

1.07 Summary

The conclusion of this thesis is therefore that there are several values which in some cases align and in some cases compete. In most of the instances the values in each system are similar but either the understanding of the value is different (e.g. protection against fraud – what is understood as fraud?) or the values are given a different weighting when they compete which then explains the different results. The question that then must be asked is whether we can accept that the values that have been identified are not simply errors or random noise⁴⁹ but represent a broader value that underlies more than just that specific decision. This can only be answered in the context of the relevant area of law and by ascertaining whether there are other decisions that reflect the same or at least similar values. A firm indicator is whether the decision has generally been accepted. The thesis also relies on the assumption that legal systems will aim to develop one efficient rule to deal with problems.⁵⁰ A second indicator of a permanent underlying value is where the decision does not follow the usual doctrinal path and the general rule is then overridden by reference to even more general norms (or in English cases by reference to construction for example), since judges are unlikely to jeopardise

⁴⁹ Mattei, 'Efficiency in Legal Transplants: An Essay in Comparative Law and Economics' (1994) 14 *International Review of Law and Economics* p.3.

⁵⁰ Dari-Mattiacci and Guerriero, 'Law and Culture: A Theory of Comparative Variation in Bona Fide Purchase Rules' (2015) 1 *Oxford Journal of Legal Studies* 11, 24; also note the point on the convergence of legal rules in light of the competition between legal rules put forward by Romano, 'Law as a Product: Some Pieces of the Incorporation Puzzle' (1985) *Journal of Law, Economics and Organizations* 1225.

certainty and consistency of their decision-making unless they see their fundamental underlying values threatened.⁵¹

It is however not only the underlying values themselves that are of interest but also the relationship in which the values stand to each other. Take for example the freedom of contract and the protection of the parties' will. Often these two values will run in parallel without affecting each other at all but in some cases freedom of contract (i.e. the freedom to choose the terms) may be limited because the courts/legislator believe one party's will is unduly limited by that freedom of contract. This relationship of the values to each other may well be further limited by different perceptions of legal doctrines. For example in Chapter 4 it will be shown that the legal understanding (dare it be said legal culture⁵²) of what constitutes fraud differs, which in consequence means that the protection of the parties' will in Germany limits the freedom of contract further than it does in England. The importance therefore for this thesis is not only to compare individual values but also to compare the relationship between values and the extent to which values compete.

Chapter two will first provide a brief overview of the changes to the German legal system and to some basic concepts, since it is accepted that the thesis is primarily aimed at a common law audience. It will also reveal that broadly German contract

⁵¹ Brownsword, 'The Law of contract: Doctrinal Impulses, External Pressures, Future Directions ' (2014) 31 Journal of Contract law 73, 86.

⁵² See FN 6 - 8; Nelken, 'Using The Concept of Legal Culture' (2004) 29 Australian Journal of Legal Philosophy 1.

law is based on the values of freedom and equality.⁵³ Chapter three will then begin with the comparative analysis of the pre-contractual duty of disclosure. A main feature of the chapter will be to identify that there are certain values which will re-appear in other chapters and will also link in with chapter four. For example, freedom of contract and protection of party autonomy are accepted as a foundational values in both jurisdictions.^{54 55} These two values can and will in most cases align⁵⁶ but freedom of contract may well be limited if it is regarded as limiting the self-determination of those who wish to conclude a contract.⁵⁷ The chapter will

⁵³ Zimmermann, 'Consumer Contract Law and General Contract Law: The German Experience' (2005) Current Legal Problems, at 466.

⁵⁴In the English case: Adams and Brownsword, 'The ideologies of contract' (1987) 7 Legal Studies 205, at p. 208 ff.; Sarah Worthington begins with this presumption in Worthington, 'Common Law Values: The Role of Party Autonomy in Private Law' ' in Robertson and Tilbury (eds), *The Common Law of Obligations: Divergence and Unity* (Chapter 14, Hart Publishing) p. 1;

⁵⁵ In the German case: 'This development [tightening the control on contracts of suretyship concluded by close family members of the main debtor] was initiated by a spectacular decision of the Federal Constitutional Court [*BVerfGE* 89, 214, 233] enjoining the Federal Supreme Court, when applying open-ended provisions such as §§ 138 (1) and 242 BGB, to pay due attention to the guarantee of the autonomy of private individuals, as enshrined in Article 2 (1) of the Basic Law (*Grundgesetz*). See Zimmermann, 'Consumer Contract Law and General Contract Law: The German Experience' (2005) Current Legal Problems, at p. 468.

⁵⁶ Zimmermann, 'Consumer Contract Law and General Contract Law: The German Experience' (2005) Current Legal Problems, at p. 465.

⁵⁷ Ibid, at 465.

take a historic view of why German law has decided to include provisions on pre-contractual duties into the BGB and compares those values to the English approach.

Chapter 4 will examine the law of mistake. It will focus on cases where there has been a mistake as to quality. This area has been chosen as it exemplifies the difference in approach and difference in values particularly well. Chapter 5 will analyse what the court/legislator in the respective jurisdictions consider to be unfair terms. Particularly interesting is the way the German courts take into account what they believe to be wider social threats (e.g. monopolies) which are not a consideration for the English courts. Chapter 6 will consider cases of impossibility and will not be looking to the cases of literal impossibility but will focus on those cases where it would be more burdensome to perform the obligation and will identify where the respective jurisdictions draw the line. Chapter 7 is the conclusion. It will set out the balance that is given to each value and which values in the relevant jurisdiction is given priority over another. From that micro perspective it will then use the comparison of the values, by using the categorisation provided by Adams and Brownsword,⁵⁸ to determine that generally Germany (within the four areas that were looked at) veers more towards the consumer-welfarist ideology and that English law tends more towards the market individualist approach.

1.08 Impact

This research has the potential to have an impact on several areas of thinking.

Firstly, it provides a comparison between four areas of German and English contract

⁵⁸ Adams and Brownsword, 'The ideologies of contract' (1987) 7 Legal Studies 205

law. Andrew Burrows in a recent article provides evidence of how much the Supreme Court relies on foreign judgments.⁵⁹ It is therefore fundamental that there should be an informed understanding of all the functional equivalent approaches in order to assess whether or not there should be such influence.

On a more basic level this thesis has both an epistemological and a practical function. It provides a broader understanding of the driving factors within our own legal system and a practical function in the sense that it helps in developing more coherent doctrines/theories either on a European/international level but also on a national level. This thesis will help the reader understand why there are different rules and mechanisms – a central aim for a comparative lawyer.⁶⁰

Understanding the underlying driving force of contract law helps in what Brownsword has described as a shift in our understanding of contracts. The contract is not anymore seen as the sole 'deal'; rather, it is a web of contracts that make up the totality of the venture. Brownsword⁶¹ presents the example of the

⁵⁹ Burrows, 'The Influence of Comparative Law on the English Law of Obligations' in Michael Tilbury and Andrew Robertson (eds), *The Common Law of Obligations: Divergence and Unity* (Hart Publishing Ltd. 2015), p. 19-21.

⁶⁰ Watt, 'Comparison as deep appreciation' in Monateri (ed), *Methods of Comparative Law* (Edward Elgar Publishing Ltd. 2012) 82, p. 86; Teubner, '*Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergencies*' (1998) 61 *The Modern Law Review* p. 11; Dari-Mattiacci and Guerriero, 'Law and Culture: A Theory of Comparative Variation in Bona Fide Purchase Rules' (2015) 1 *Oxford Journal of Legal Studies* 1, p. 32.

⁶¹ Brownsword, 'The Law of contract: Doctrinal Impulses, External Pressures, Future Directions ' (2014) 31 *Journal of Contract law* 73, at 83.

shopping centre that is to be opened. A deal is brokered with a major retailer, who will attract lots of the customers. Many smaller retailers decide to enter into contracts for shops in the retail park on the basis that the large retailer will be there. The question is then whether the large retailer could just end their contractual relationship without influencing the web of contracts that surround their deal. In understanding whether such an approach would fit with the underlying values can provide a solid basis for a change in policy if that is seen to match the underlying values of the legal systems.

There is of course also the European level. Understanding which values (and the reasons behind those values) underlie particular rules allows for an assessment of whether harmonisation of those rules is desirable.

Chapter 2 – Introduction to German Law

This chapter is designed to provide a brief overview of the origin of the German civil code, the most important change with regard to the law of obligations and an overview of the structure of the German civil code.

2.01 A brief history of the German civil code

The German civil code and therefore German law as we know it today did not exist until 1900. In the late 15th Century canon law and local legal systems of the different kingdoms in Germany prevailed. Local laws would generally take priority over any other laws but where there was no local law late Roman law (*corpus iuris Civilis*) would be used. In the 18th century new legal codes (e.g. Preußisches Allgemeines Landrecht, ABGB – Austrian Civil code) were developed that renewed Germanic legal thought. As the time for the inception of the German civil code came closer two main schools of thought prevailed. The first was the school of natural law (with writers such as Thibaut who was in favour of the German civil code) and the second was the historical school of law (with writers such as Savigny who believed that there was no need for such a code).⁶² Savigny and Thibaut were the two most prominent legal thinkers of their time and were professionally opposed.⁶³ Thibaut advocated a unified, simple German civil code.⁶⁴ He was

⁶² Foster and Sule, *German Legal System and Laws* (3 edn, Oxford University Press 2008), p. 17-27.

⁶³ Hattenhauer, *Thibaut und Savigny* (Verlga Franz Mahlen Muenchen 1973), p. 9; MacMillan, *Mistakes in Contract Law* (Hart Publishing 2010), p. 137.

⁶⁴ Thibaut, *Ueber die Nothwendigkeit eines allgemeinen buergerlichen Rechts fuer Deutschland* (Mohr und Zimmer 1814) .

influenced in part by the Code Napoleon which outwardly he protested against but the ideas of which he would have liked to have seen integrated into a German civil code.⁶⁵ Natural law is based on man-made rational rules and receives its legitimization through that same rationality. Savigny opposed Thibaut's idea to abolish the Roman law system in return for a unified German code and favoured keeping the status quo.⁶⁶ The historical school of law that Savigny belonged to, defended the idea of the law growing through history. He therefore argued that before any attempt could be made to develop a unified code it needed to be fully understood in terms of methodology and needed to be cultivated from there.⁶⁷ Roman law was to provide the basis. Thibaut died in 1840 and Savigny's opinion was then followed which meant that no unified German civil code was developed. Both scholars found their roots in Roman law and even though Savigny's approach triumphed initially, a unified German civil code exists today. It comes as no surprise that Roman law had a strong influence on the way in which the German civil code was drafted since both scholars, though not directly involved in the process of drafting the legislation, held positions as professors of Roman law and were the main sources for understanding German law. This thesis will, in some cases, trace

⁶⁵ Hattenhauer, *Thibaut und Savigny* (Verlga Franz Mahlen Muenchen 1973), p.40-45.

⁶⁶ Savigny, *Vom Beruf unserer Zeit fuer Gesetzgebung und Rechtswissenschaft* (Mohr und Zimmer 1814).

⁶⁷ Posch, *Grundzuege fremder Privatrechtssysteme: ein Studienbuch* (Boehlau Verlag Gesellschaft m.b.h. und Co.KG. 1995), p.24-25.

the values back to the law pre-dating the German civil code and look at the influence these values had on the civil code and legal thought.

On 1 January 1900 the German civil code (BGB) came into force. It had been in the making for over 26 years and signified the unity of the German *Reich*.⁶⁸ With over 100 years under its belt the German civil code seems to have stood the test of time but this does not imply that the code has remained the same. On 1 January 2002 the German law of obligations was modernized with the 'Gesetz zur Modernisierung des Schuldrechts'. There had been some previous attempts to modernise the law of obligations but these had gradually faded into the background.⁶⁹ This is not to say that the BGB remained untouched for 100 years. The BGB was continually supplemented with for example the 'Gesetz zur Regelung des Rechts der Allgemeinen Geschäftsbedingungen 1977' (the law to regulate standard contract terms).

After much discussion, a commission⁷⁰ was asked to restructure the law to make it clearer and more modern. After 1995 the idea of a new law of obligations slowly faded into the background and was only revived by the necessity to implement the

⁶⁸ Zimmermann, 'Characteristic Aspects of German Legal Culture' in Zetkoll and Reimann (eds), *Introduction to German Law* (Kluwer Law International 2005), p. 7.

⁶⁹ See Justiz, *Gutachten und Vorschläge zur Überarbeitung des Schuldrechts*, vol 1 (1981) *ibid* Justiz, *Gutachten und Vorschläge zur Überarbeitung des Schuldrechts*, vol 3 (1983) ; for more detail see Zimmermann, 'Characteristic Aspects of German Legal Culture' in Zetkoll and Reimann (eds), *Introduction to German Law* (Kluwer Law International 2005), p. 14.

⁷⁰ Bundesminister der Justiz, *Abschlussbericht der Kommission zur Überarbeitung des Schuldrechts* (1992)

Consumer Sales Directive⁷¹ by January 2002. The modernisation provided an opportunity to incorporate into the legislation rules that the courts had developed in order to supplement the code (e.g. pre-contractual liability which was transposed into § 311 BGB).⁷²

The main concerns which motivated the intention for the reform in 2002 were (i) the integration of specific statutes into the BGB (ii) the incorporation of specific contractual relations, which were deemed important enough to warrant special attention (iii) general reform of specific types of obligations and (iv) the need to adapt the general law of obligations to international developments.⁷³ In addition the commission took it upon themselves to integrate the judge-made law which had become enshrined in the German law of obligations into the new BGB.⁷⁴

2.02 General Norms

An interesting feature of German law is the structure within which the law of obligations operates. The system subscribes to certain overarching norms which are

⁷¹ Directive 1999/44/EC of the European Parliament and Council on certain aspects of the sale of consumer goods and associated guarantees.

⁷² Zumbansen, 'The Law of Contracts' in Mathias Reimann and Joachim Zekoll (eds), *Introduction to German Law* (2 edn, Kluwer Law International 2005), p. 185.

⁷³ Daeubler-Gmelin, 'Die Entscheidung fuer die so genannte Grosse Loesung bei der Schuldrechtsreform' (2001) *Neue Juristische Wochenschrift* 2281.

⁷⁴ For example, the pre-contractual duties of disclosure (more specifically the concept of culpa in contrahendo) had been developed by the judges by relying on § 242 BGB. The commission created § 311 BGB in order to provide a new home for the pre-contractual duties, separate from § 242 BGB. Chapter 3 will discuss this development in more detail.

called 'Generalklauseln' (general clauses). These clauses apply to all the relationships of private law. The two main general clauses are § 242 BGB – the requirement of good faith – and § 138 I BGB – the requirement that contracts which are contrary to good morals are void. These provisions are left deliberately vague because they are meant to fulfil three roles.⁷⁵ The first is that they give the judges the power to divert from the strict rules of the BGB in the interest of justice, where a result would be particularly harsh.⁷⁶ The second is that it allows the judges to develop the existing law where circumstances have changed.⁷⁷ The third is that it allows the judges to ensure that wider political policies are taken into account in their reasoning.⁷⁸ This final role can ensure, for example, that the judges can intervene where a contract is contrary to the principle of the social state ('Socialstaatsprinzip')⁷⁹ but it has in the past meant that other negative political values, e.g. during the national socialist era' can infiltrate the German legal system.⁸⁰ The general norms are particularly valuable for this thesis in tracing

⁷⁵ Markesinis, Unberath and Johnston, *The German Law of Contract: A Comparative Treatise* (2nd edn, Hart Publishing 2006), p. 22-25.

⁷⁶ Ibid, p. 23.

⁷⁷ Ibid, p. 24.

⁷⁸ Ibid, p. 24.

⁷⁹ According to Art. 20 of the German Constitution; ibid p.39; Zimmermann, 'Characteristic Aspects of German Legal Culture' in Zetkoll and Reimann (eds), *Introduction to German Law* (Kluwer Law International 2005), p. 22.

⁸⁰ Whilst the constitution cannot have direct effect on the law of obligations (*BVerfGE* 7, 198) it does have indirect horizontal effect. (Markesinis, Unberath and Johnston, *The German Law of Contract: A Comparative Treatise* (2nd edn, Hart Publishing 2006), p. 37-43.

values because they are both indicators of legislators' values and offer an opportunity to give expression to underlying values.

Chapter 3 – Pre-contractual Duties (Breaking off negotiations)

3.01 Introduction

The negotiation stage is often an essential pre-requisite to a contract. In some cases it may be non-existent or simply take the form of enquiring about the price, quantity or quality and in other cases there may be long protracted negotiations leading to lengthy contractual documents.⁸¹ However, negotiations may for a variety of reasons come to an end without a binding agreement being reached. Both the German and English system in principle allow the parties to walk away from negotiations without further liability under the principle of freedom of contract.⁸² The negotiation stage is designed for the parties to establish whether they are in agreement without the fear of being immediately bound (or the fear of liability). However, according to the German author von Jhering there are circumstances where there should be liability where one party has induced the other to incur a loss without entering into a contract.⁸³ The liability arises, he

⁸¹ Farnsworth, 'Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations' (1987) 87 Columbia Law Review, p.219

⁸² E.g. *Walford v Miles* [1992] 2 AC 128.

⁸³ See his work on the concept of culpa in contrahendo in Von Jhering, *Jahrbücher für die Dogmatik des heutigen römischen und deutschen Rechts* (4th edn, F. Maucke (accessed via: Digitale Bibliothek des Max-Planck Institut für Europäische Rechtsgeschichte) 1861).

argued, from the principle of *culpa in contrahendo*.⁸⁴ The idea of *culpa in contrahendo* was later adopted by the German Supreme Court to circumvent the difficulties of the rather harsh results of the lack of vicarious liability.⁸⁵ Adopting the principle of *culpa in contrahendo* opened the door for much broader use of the principle. The broad approach in Germany, through the introduction of *culpa in contrahendo*, is that a party can be liable for breaking off negotiations in bad faith.⁸⁶ A party who is regarded as liable for breaking off the negotiations will have to cover the reliance loss incurred in the expectation that there would be a contract.⁸⁷

The English approach, which does not rely on *culpa in contrahendo*, generally takes the stance that there is no liability for breaking off negotiations.⁸⁸ There are however some circumstances - for example where fraud is involved or where the other party has been unjustly enriched - where the courts are willing to at least ensure that the other party does not gain from breaking off the negotiations, and in some cases it seems that the courts will stretch the principles to achieve almost the same result as the German courts. Where one party is either deliberately (Ch. 3.05) or negligently (Ch. 3.11) mislead, English law will impose tortious liability. In all other cases, with the exception of the estoppel cases (Ch. 3.07 and 3.08),⁸⁹ the end

⁸⁴ Ibid, p.2.

⁸⁵ *BGH NJW 1962, 31* .

⁸⁶ Now contained in § 311 BGB.

⁸⁷ § 122 BGB.

⁸⁸ *Walford v Miles* [1992] 2 AC 128

⁸⁹ With the exception of the estoppel cases.

result is that the English courts will only ensure that the other party is not unjustly enriched.

The real difference therefore appears in the cases where one party changes their mind during the negotiation stage for no reason (Ch. 3.09 and Ch. 3.10). The reason for this difference, it is argued in this chapter, is that the German courts have balanced the underlying values differently. Both systems agree in principle on some form of fault-based liability at the pre-contractual stage and the argument will be made that in cases where the other party changes their mind or suddenly increases the price (or other conditions) there may well be liability in English law through negligent or fraudulent misrepresentation (Ch. 3.08). However, the understanding of what is to be viewed as 'fault' at the pre-contractual stage differs, which in turn means that the German courts are willing to go further in compensating the party that has incurred a loss than the English courts are.

3.02 Freedom from contract and the protection of the will

There is some evidence to suggest that freedom of contract in itself is understood differently in each jurisdiction or at least that the concept is derived from alternative approaches.⁹⁰ The German approach is based on the autonomy of the individual,⁹¹ which is grounded in the theory of the will rather than its declaration

⁹⁰ Micklitz, 'On the Intellectual History of Freedom of Contract and Regulation' (2015) European University Institute, p.8.

⁹¹ Influenced first through Kant and then Savigny, see Zimmermann, 'Savigny's Legacy: Legal History, Comparative Law, and the Emergence of a European Science' (1996) 112 Law Quarterly Review, 576-605.

thereof.⁹² From this point of view it is easy to see that the freedom from contract is an essential element in protecting the party's autonomy because if the party did not have the requisite 'will' to enter into a contract then there should not be a contract – even though the other may have believed that a contract would come about. The English approach, by contrast, views freedom of contract as the freedom to engage in economic transactions voluntarily.⁹³ This freedom, viewed from this angle, is rooted deeply in the economic culture, i.e. it is free from outside interference from, for example, statutes.⁹⁴ With the exception of consumer contracts, in English law freedom of contract means that the parties can generally agree on the content of their contractual agreement as they wish.⁹⁵ Any paternalistic overtones⁹⁶ should be seen as inhibiting that freedom.⁹⁷ In contrast to the German approach, where paternalistic outside influences are welcomed, the focus is not so much on the protection from contracts but the protection of contracts from 'outside' influences. The conclusion at this point must be that,

⁹² Micklitz, 'On the Intellectual History of Freedom of Contract and Regulation' (2015) European University Institute, p.15.

⁹³ Ibid. p. 9

⁹⁴ Goff, 'The Future of the Common Law' (1997) 46 International and Comparative Law Quarterly 745

⁹⁵ Posner, *Economic Analysis of Law* (8th edn, Aspen Publishers 2011), p.85 ff.

⁹⁶ Unless there is clearly some defect the contracting process or one of the parties is incompetent: Epstein, 'Unconscionability: A Critical Reappraisal' (1975) 18 Journal of Law and Economics

⁹⁷ The question of whether this is true is left to others to answer but the point to be made here is that this is the English understanding of freedom of contract - Brownsword, 'The Ideologies of Contract' (1987) 7 Legal Studies 205.

through the protection of the will, the basic starting point⁹⁸ of finding that a contract in fact exists is more difficult in the German cases due to the fact that the other may not have the requisite will.⁹⁹ This conclusion influences this chapter in two ways. The first is that there may be instances where the English courts are more likely to find that a contract exists¹⁰⁰ where the parties were still at the negotiation stage¹⁰¹ and therefore award expectation damages for breach of contract when the other party refuses to perform, where the German courts will only award the reliance interest through devices such as *culpa in contrahendo*.¹⁰² The consequence therefore is that there is already a difference in value in relation to the freedom of contract, namely in a stronger focus by the German courts on the freedom from contract. The second is that the English approach delivers a difference in outcome when they find that there is a contract, i.e. expectation rather than reliance interest.

⁹⁸ Though Chen-Wishart argues that protection from contract is one of the aims of consideration - Chen-Wishart, 'In Defence of Consideration' (2013) 31:1 Oxford University Commonwealth Law Journal 209, p. 214.

⁹⁹ For more detail on the will-theory see Ch. 4.02

¹⁰⁰ It is accepted here that this may not be merely an economic freedom that has influenced the courts but that it is interlinked with the argument for recognising contracts at the negotiation stage to ensure that the parties take responsibility for the expectations that their actions reasonably produce in others. However, it does not change the overall argument.

¹⁰¹ Due to the objective principle, see *Smith v Hughes* [1871] 6 LR 597 (QB).

¹⁰² See Ch. 3.03 below.

3.03 Culpa in contrahendo

Von Jhering's approach

One of the main devices that is used by the German courts to alleviate some of the harsh results delivered by the BGB in cases of breaking of negotiations is *culpa in contrahendo*.¹⁰³ The best starting point to understand the development of the phenomenon of *culpa in contrahendo* is the work of Rudolph von Jhering's in 1861.¹⁰⁴ Von Jhering's overarching aim was to tie the then fragmented system of German law to that of Roman law in order to build a system of natural jurisprudence.¹⁰⁵ In relation to the pre-contractual stage, Von Jhering was mainly concerned with the loss flowing from the mistake of one party which had to be borne by the other party who carried no fault in the mistake.¹⁰⁶ Roman law¹⁰⁷ required the parties to have a meeting of the minds and if there was a lack of that meeting of the minds, then the contract was held void *ab initio*. Von Jhering describes the problem in reference to a mistake,¹⁰⁸ i.e. one of the parties, usually

¹⁰³ Less so now through the introduction of § 311 BGB (see below).

¹⁰⁴ Von Jhering, *Jahrbücher für die Dogmatik des heutigen römischen und deutschen Rechts* (4th edn, F. Maucke (accessed via: Digitale Bibliothek des Max-Planck Institut für Europäische Rechtsgeschichte) 1861).

¹⁰⁵ See for example his publication: Rudolph von Jhering, '*Geist des römischen Rechts auf den verschiedenen Stufen seiner Entwicklung*' (Vol. 3) Verlag Breitkopf und Härtel (1865).

¹⁰⁶ *Ibid*, p. 2.

¹⁰⁷ For more explanation on the development from Roman law to the BGB see Ch. 2.02.

¹⁰⁸ Von Jhering, *Geist des römischen Rechts auf den verschiedenen Stufen seiner Entwicklung*, vol 3 (Verlag Breitkopf und Haertel 1865), p 2.

the buyer, has made a mistake which in turn would have resulted in the contract being void *ab initio* but the seller has incurred an expense. For example A orders 100 kg of a product but meant to buy 100 lbs. On delivery he rejects the order for not being the correct amount.¹⁰⁹ The parties never had a meeting of the minds and therefore no contract was ever created. Nevertheless, the seller has to bear the loss of transporting the goods and any potential drop in the market.

The problem that von Jhering had particularly envisaged was the case where the simple return of the goods was not sufficient to compensate the seller for his loss, where for example the return of the goods may cause them to devalue.¹¹⁰ The following example illustrates the problem:¹¹¹ A orders bananas and he is mistaken as to the amount – as in the case above. A then rejects the delivery. B would not only have to bear the cost of transporting the bananas but would probably have to sell them at a discounted rate or might simply have to throw them away due to the fact that they are now older. This result is clearly unfair to B who was in the belief that a contract had been created; however, the law at that time would have

¹⁰⁹ Ibid. p. 39.

¹¹⁰ Von Jhering, *Jahrbücher für die Dogmatik des heutigen römischen und deutschen Rechts* (4th edn, F. Maucke (accessed via: Digitale Bibliothek des Max-Planck Institut für Europäische Rechtsgeschichte) 1861) p. 4.

¹¹¹ This example was created by the author.

declared the contract void *ab initio* as there was no meeting of the minds because A had meant to buy significantly fewer bananas.¹¹²

Von Jhering continued to expand this problem into agency law and finds the following example¹¹³: If Z asks his friend to order a quarter of a box of cigars but the friend misunderstands, orders 4 boxes and Z then rejects the delivery, Y, the seller of the cigars, then has to bear the loss due to the fact that there was never a meeting of the minds between the seller and the buyer. As the friend was expressly acting as an agent, liability would not have fallen on him. The injustice is apparent; the mistake was made between Z and his friend and the seller did exactly as he was instructed, yet he has to carry the loss.¹¹⁴

Von Jhering argued that all these circumstances could be decided on the basis of attributing fault or *culpa* – to use the Latin word.¹¹⁵ In the first example therefore the fault lies with the person who confused lbs and kg and in the agency scenario the fault lies with the agent, who misunderstood his principal.¹¹⁶ Von Jhering thereby shows that fault, even without a contract, could be a ground on which to

¹¹² Von Jhering, *Jahrbücher für die Dogmatik des heutigen römischen und deutschen Rechts* (4th edn, F. Maucke (accessed via: Digitale Bibliothek des Max-Planck Institut für Europäische Rechtsgeschichte) 1861) p.22 ff.

¹¹³ Ibid. p. 36-40.

¹¹⁴ Although the problem could now be solved on the basis of the agent's warranty of authority.

¹¹⁵ Von Jhering, *Jahrbücher für die Dogmatik des heutigen römischen und deutschen Rechts* (4th edn, F. Maucke (accessed via: Digitale Bibliothek des Max-Planck Institut für Europäische Rechtsgeschichte) 1861) p. 36.

¹¹⁶ Ibid. p. 37 ff.

provide compensation. However, he also describes that a purely fault based remedy without an underlying contract could have very serious adverse effects.¹¹⁷ The introduction of such a rule would mean that anything said or done even in a social context could lead to liability. This could range from promising to have dinner on the table by a certain time, to promises of good weather. A modern example of this could be if M were to ask N for directions and N were to make a mistake, N could be held liable for his mistaken directions to M since it was N's fault that M had to spend more petrol to get to his destination – an unreasonable outcome. Therefore von Jhering concludes that *culpa* on its own is insufficient to establish liability.¹¹⁸

However, von Jhering does not entirely move away from a fault-based remedy and utilises the idea of a contractual relation. He decides to establish liability on the basis of a contractual rather than a tortious one – even though the contract may not have come into existence. Von Jhering proposes that the word 'void' should be analysed in a different light. 'Void' is not the absence of any duty, it is just the absence of the directly visible contractual duties¹¹⁹. So that in the cases of the bananas or the cigars *culpa*, i.e. the fault of A or Z for not clearly communicating what they meant to contract for, combined with the underlying contract, despite its being void, creates the liability.

¹¹⁷ Ibid. p. 25.

¹¹⁸ Ibid. p. 25 - 27.

¹¹⁹ Ibid. p. 32-35.

Von Jhering accepts that finding *culpa* is not always easy and provides the example of a drunk who orders a particular dish for the next day.¹²⁰ The owner of the business takes his order and delivers the dish the next day. The now sober man rejects the delivery – the contract being void on the basis of lack of capacity. Here *culpa* lies with the owner of the business, he should have known better than to contract with the drunk.^{121 122} Von Jhering describes a further scenario in which the drunk asks a waiter (this time an agent for the drunk) to order him a horse and cart and the drunk then rejects the cart, *culpa* lies with the drunk.¹²³ *Culpa* here is the fact that he brought himself into the state of being drunk and that is the drunk's fault. Interestingly this case may be treated similarly today. If the drunk had been so drunk that he was incapable of declaring his intention¹²⁴ then the agent would have acted outside of his authority, making him a *falsus procurator*. Suffice it to say at this point though that the innocent owner of the horse and cart would have had redress either against the waiter or the drunk.

¹²⁰ Ibid. p. 21.

¹²¹ See BGHZ 152, 75 .

¹²² This specific situation may be treated differently today as the drunk would have to have been so drunk that he would have been incapable of ordering the food. See also § 105 (2) BGB.

¹²³ Von Jhering, *Jahrbücher für die Dogmatik des heutigen römischen und deutschen Rechts* (4th edn, F. Maucke (accessed via: Digitale Bibliothek des Max-Planck Institut für Europäische Rechtsgeschichte) 1861), p.21.

¹²⁴ There is a requirement of two matching ,*Willenserklärungen*' – declarations of intent - for a valid contract.

The situation becomes more difficult in relation to agency relationships if the agent himself makes a mistake. An example may be a confused agent or even a malfunctioning telegraph, where the order was correctly given to the agent but incorrectly transmitted to the seller. In both cases von Jhering concludes that *culpa* lies with buyer for using the medium.¹²⁵ The buyer could have transmitted the message in person but decided to use a different means of communication – the distortion of the message is therefore his responsibility.¹²⁶ In other words the buyer has to bear the risk of using a different medium than personal contact. Presumably the situation would change if the seller stipulated that the only way of accepting was by using a telegraph. Nonetheless, this means that von Jhering has found a viable way of attributing fault. Interestingly, he fails to mention pre-contractual relations as giving rise to any sort of liability.¹²⁷

The obligation which is therefore created is based on '*culpa*' - fault. *Culpa* finds its roots in the intended contractual relation. One party has suffered a detriment because he relied on the representations of the other and/or the objective surrounding circumstances that a contract had been or certainly will be formed -

¹²⁵ Von Jhering, *Jahrbücher für die Dogmatik des heutigen römischen und deutschen Rechts* (4th edn, F. Maucke (accessed via: Digitale Bibliothek des Max-Planck Institut für Europäische Rechtsgeschichte) 1861), p. 72 ff.

¹²⁶ Ibid.

¹²⁷ Ibid. p. 43-44.

an idea which the Romans had already developed,¹²⁸ at least in more limited approach.¹²⁹

The essential element from von Jhering's approach is that blameworthy conduct outside a contract (but within a contractual context) that leads to loss should lead to relief for the innocent party. The contractual context that von Jhering describes is when the contract turns out to be void. It is unlikely that von Jhering was even considering cases where one party had broken off the negotiations and thereby caused a loss. The need for von Jhering's approach arose through reliance on the historic school of thought (rooted in Roman traditions)¹³⁰ and Savigny's will theory which (put simply) causes the contract to be considered void if the other party did not have the requisite will to enter into the contract.¹³¹

Whilst von Jhering's original idea of *culpa in contrahendo* was not entirely transferred into the first German civil code (the BGB) of 1900 it can be said that a few basic ideas were adopted.¹³² More importantly though, and similar to von

¹²⁸ For more detail on the Roman origins see Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (Clarendon Press 1996) p. 243-245.

¹²⁹ Ibid p. 9.

¹³⁰ See Ch. 2.01.

¹³¹ For more detail on Savigny's approach see Ch. 4.02.

¹³² From the BGB of 1900: § 122 BGB – the need to compensate on a reliance basis if the contract is void for mistake, § 166 BGB – only the principal's state of mind is relevant in cases of mistake, § 179 BGB – liability of the agent in cases where he does not have the authority of the principal, §§ 307 and 309 – reliance interest for initial impossibility (see Chapter 5); Cartwright and Hesselink, *Precontractual Liability in European Private Law* (Cambridge University Press 2011), p. 32.

Jhering's approach, the courts developed a fault-based remedy for loss flowing from contractual negotiations,¹³³ mainly because the founders of the BGB had left much unsaid¹³⁴. The motivation of the judiciary, in line with von Jhering concept, was to provide for situations falling outside those anticipated by the BGB.

In 1911, *culpa in contrahendo* received considerable appreciation through the '*Linoleum case*'¹³⁵, which bridged the gap in legislation for vicarious liability. The claimant entered a shop belonging to the defendant. She had already made some purchases in the general shopping complex and now intended to buy a linoleum carpet. After looking around she asked a shop assistant for advice and chose a particular style which she intended to buy. The shop assistant attempted to fetch the carpet she had selected, when he negligently hit two other rolls of carpet throwing the claimant and her child, to the ground. Owing to the injuries caused by the incident no contract was ever concluded.

The question put before the court was whether the owner of the shop, who had employed the assistant, could be held liable. Had the shop owner been negligent himself the problem would never have occurred and liability would have laid in tort law. However, German law provided a rather weak system of vicarious liability in which the shop owner was only liable if he had been negligent in choosing the shop assistant. If he was able to show that he had chosen and supervised the assistant

¹³³ See Ch. 3.07 ff. below.

¹³⁴ E.g. now §§ 311; 242 BGB.

¹³⁵ RGZ 78, 239 (1911) *Linoleum Case* .

diligently he would not be liable for the assistant's negligence.¹³⁶ Most of the other legal systems of the world (including England) have opted for vicarious liability of the owner of the shop.¹³⁷ In order to circumvent the harsh results caused by the direct application of legislation the court was faced with the challenge of circumventing the legislation. The difficulty was that the assistant could be held liable on the basis of the '*Deliktshaftung*' – liability on the basis of his neglect of his duty of care but this would probably not have provided the claimant with redress. As the shop owner was able to show that he had diligently selected and supervised his employee he could only be held liable on the basis of the '*Vertragshaftung*' – the contractual duties - due to the fact that § 278 BGB imputes the negligence of the assistant to the owner of the shop so long as there is an underlying contractual relationship.¹³⁸

The '*Linoleum Case*'¹³⁹ helped open up the law to a stricter vicarious liability¹⁴⁰ but it also created a general liability not physically or economically to harm the

¹³⁶ § 831 I BGB.

¹³⁷ Markesinis, *A Comparative Introduction of the German Law of Torts* (3rd edn, Clarendon Press 1994), p. 677.

¹³⁸ For more details on the effects of § 278 BGB see Markesinis, *The German Law of Contract: A Comparative Treatise* (2nd edn, Hart Publishing 2006), p. 95.

¹³⁹ RGZ 78, 239 (1911) *Linoleum Case* .

¹⁴⁰ The duty was even further in the BGHZ 66, 51 (1976) *Vegetable Leaf Case* where, a daughter had accompanied her mother for a day of shopping. They entered a shopping centre with the intention of purchasing when the daughter slipped on a vegetable leaf and suffered injury. The problem the court was faced with this time was that the daughter was a minor and could therefore not have any

interests of parties involved in the negotiation of contracts which eventually lead to the incorporation of *culpa in contrahendo* into the BGB. § 311 BGB codified the previous case law to offer protection in cases where the other party breaks off negotiations without good reason.

Blameworthy behaviour and the protection of the BGB

The idea that § 311 BGB falls back on is that through conduct of one of the parties the other party incurs a loss at a pre-contractual stage and that but for the conduct of the other party the other would not have incurred the loss. In a scenario where A informs B that he may be willing to sell at price X, B incurs cost and A then discovers that the market has changed A will not be (and should not be) liable for B's loss. However, in the case where A leads B to believe that they will definitely enter into the contract and for that reason B incurs a loss, the German courts have been

contractual connection to the shop – opposed to the woman in *BGHZ 85, 315*, where there was a direct tortious claim. Nevertheless, the owner of the store was held liable by attributing the daughter's presence to the mother and allowing the mother a quasi-contractual relationship with the owner of the shop. The quasi-contractual relationship arose by the mere fact that they had entered the shop with the intention of purchasing.¹⁴⁰ These cases illustrate recognition of a pre-contractual relationship which did not go unnoticed by the legislator. Both *RGZ 78, 239 (1911) Linoleum Case* and *BGHZ 66, 51 (1976) Vegetable Leaf Case* create a fictitious quasi-contractual relationship based on tortious principles, i.e. the avoidance of harm. In this case though it is not harm that the other has caused through their actions but harm that they caused through their inaction. A further mechanism within German law is the contract with protective effect for third parties ('Vertrag mit Schutzwirkung zugunsten Dritter') which arises from § 311 (2) BGB. Since the principle also arises from *culpa in contrahendo* it will not be discussed separately.

willing to provide B with a remedy.¹⁴¹ The differentiation between the cases is that the courts have used von Jhering's analysis that blameworthy behaviour should lead to liability, although he meant this to apply to cases of mistake. The argument here therefore is that the underlying principle that the courts have been following is that A will be liable for reliance damages where B has incurred a loss through the blameworthy behaviour of A in a contractual context. In effect it is the protection of an informal trust relationship¹⁴² or reliance on what A has stated. The addition of the contractual context means that the parties must have entered into some form of relationship to each other, in the *Linoleum*¹⁴³ and *Vegetable Leaf*¹⁴⁴ cases it was the entry into the store which brought the parties into a relationship where they had to protect the interests of the other party. The liability for blameworthy behaviour is limited through other competing values, one of which is the protection of the BGB provisions (though it will be shown later that this is also limited by other values).¹⁴⁵

As indicated at the beginning, the next step will be to look at a simple scenario, where one party has conferred a benefit on the other and the negotiations have

¹⁴¹ Now covered by § 311 (1) BGB.

¹⁴² E.g. BGHZ 76, 343, 349 (Failed Shopping Centre case), confirming BGHZ 71, 386, 395: '*During the negotiation of a contract the other party owes, reasoned on the basis of a quasi-contractual trust relationship, a reasonable duty to take into account the justified interests of the other party.*'

¹⁴³ RGZ 78, 239 (1911) *Linoleum Case* .

¹⁴⁴ BGHZ 66, 51 (1976) *Vegetable Leaf Case* .

¹⁴⁵ A value which is also prominent in other areas – see Chapter 5 for example.

then broken down. It will be shown there that, through one way or another, both systems will provide some sort of remedy.

3.04 Unjust Enrichment

The solution to different cases, i.e. the tools that the courts use, are the next element in the analysis. The first case, centred on the English solution of unjust enrichment, will set the baseline for the minimum standard of recovery for the party that has incurred a loss at the pre-contractual stage. It will show that both systems can, through different mechanisms, solve the following scenario: A has entered negotiations with B and encouraged B to provide her with a benefit (for example by shipping the goods in advance, or preparing plans for a building project).

The English approach to restitution

The basic principle of the law of restitution is to provide the foundation for a claim where one party has been unjustly enriched at the expense of another.¹⁴⁶ The general rule is that where one party has gained from encouraging the other to incur a loss then they will have to return their gain (but not pay for the other's loss).¹⁴⁷ In

¹⁴⁶ *Boake Allen Ltd v HMRC* [2006] EWCA Civ 25 (HL) As opposed to restitution for wrongs which won't be discussed here. Wrongs for breach of contract would include cases such as *Attorney General v Blake* [2001] 1 AC 268 (HL), where the courts compensated for the gain.

¹⁴⁷ The existence of restitution, as the basis for a claim, was not formally accepted by the House of Lords until 1991 in *Lipkin Gorman v Karpnale Ltd* [1991] 2 AC 548 (HL). However, this does not mean that cases prior to this went unresolved. As early as 1760, Lord Mansfield (in *Moses v Macferlan* 2 Burr 1005) held that if from 'the ties of natural justice' there is an obligation to refund, then the law

*British Steel*¹⁴⁸ the plaintiffs were asked to produce steel nodes and the defendant sent a draft contract which was rejected by the plaintiff. The negotiations continued and all the deliveries of the steel nodes were made on time except for the last one. The defendant then attempted to rely on the draft contract but the court held that (particularly due to the fact that the claimant had rejected the draft) no contract had been formed. Recovery was therefore allowed on a restitutionary basis for the reasonable price of the steel nodes that had been supplied. The case in itself is not surprising, however, had British Steel produced the steel nodes (which were of no use to anyone else as they were made to the plaintiff's specifications) but not delivered them when the negotiations broke down, it would seem that a claim in restitution would fail, unless the courts would be willing to circumvent the principle of unjust enrichment and focus on the loss of that British Steel had incurred (which is highly unlikely). No claim lies in restitution in cases where the claimant, in reliance on the statement of the defendant that they will enter into a contract, has incurred a loss but there has been no enrichment to the defendant.¹⁴⁹ In such a case, however, as will be shown at Ch. 3.05 and Ch. 3.06, the claim may lie in misrepresentation.

will imply a debt as if there were a contract. He therefore decided to imply a promise to refund the money by which the defendant had been enriched.

¹⁴⁸ *British Steel Corp v Cleveland Bridge & Engineering Co Ltd* [1984] 1 All ER 504 (QB).

¹⁴⁹ However, there may be a claim in fraud, see *Derry v Peek* [1889] 14 App Cas 337 (HL).

Even a claim in restitution may be limited if it would circumvent statutory provisions. In *Sinclair v Brougham*¹⁵⁰, the question put before the House of Lords was whether those who had paid in to the building society were allowed to recover their money. As the contract was void for illegality the court held that implying a contract,¹⁵¹ and thereby allowing for the repayment (i.e. allowing it to have the same effect as a claim in restitution), would be circumventing the purpose of the legislation.¹⁵² In other words, the purpose of the legislation was to void the contracts and therefore implying a contract would be effectively to annul the legislation.¹⁵³ The conclusion that can be drawn from this case is that the limitation on a claim in restitution is where it would contravene a statutory provision.

¹⁵⁰ *Sinclair v Brougham* [1914] AC 398 (HL).

¹⁵¹ Note that the implied contract theory in restitution cases has since been abandoned (*United Australia Ltd v Barclays Bank Ltd* [1941] AC 1 (HL)) though there is some inclination that cases after this have used the implied contract theory (e.g. *Guinness Plc v Saunders* [1990] 2 AC 663 (HL), 689 (Lord Templeman)).

¹⁵² The claim succeeded on a different point of law.

¹⁵³ Note though that there have been cases since *Sinclair v Brougham* where the money has been returned. In *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669 (HL) the House of Lords held that the principle of *Sinclair v Brougham* [1914] AC 398 (HL) did not apply on the basis that the swaps transaction was not itself a borrowing transaction. Instead they held that it was a future contract which does not involve the lending of money. From this it is now assumed that even where a loan is involved the money could be returned on the basis that restitution is imposed by law which is different from the contractual obligation to repay the loan (see Virgo, *The Principles of the Law of Restitution* (2nd edn, Oxford University Press 2006)).

In the case of *William Lacey*¹⁵⁴ the claimant had prepared estimates for rebuilding a property which had been destroyed during the war. The defendant used the estimates to present the plans to the war commission. The plans in turn increased the value of the property. Once the war commission had approved the plans the defendant informed the claimant that they had chosen a different contractor to complete the works when in reality they sold the property to a third party. In this case there had never been a contract between the parties. Barry J found that the action was based on a quasi-contract and that the courts were able to find a promise, irrespective of the intentions of the parties at the time. He placed much emphasis on the fact that the work had not been done gratuitously and that it had been requested by the defendant. He was unable to see a difference between a contract erroneously believed to be in existence¹⁵⁵ and work done which was to be paid for out of the proceeds of a contract which both parties erroneously believed was about to be made.¹⁵⁶ An award on the *quantum meruit* basis for the price of preparing the estimates was made.¹⁵⁷

The main point here is, bearing in mind that in 1975 the implied contract theory was still prevalent, that Barry J placed the erroneous belief that a contract existed

¹⁵⁴ *William Lacey (Hounslow) Ltd v Davis* [1957] 1 WLR 923 (QB).

¹⁵⁵ Thereby referring to the judgment of Greer L.J. in *Craven Ellis v Canons Ltd* [1936] 2 KB 403 (CA), 410.

¹⁵⁶ *William Lacey (Hounslow) Ltd v Davis* [1957] 1 WLR 923 (QB), 939.

¹⁵⁷ In this case the claimant was not allowed to quantify the damages in respect to the professional scales.

and the erroneous belief that a contract would ensue on equal footing.¹⁵⁸ The difference between these approaches lies in the fact that the belief that a contract exists, which later turns out to be void, is based on mistake, whilst the anticipation of a contract is a prediction. If no contract is ever entered into then the prediction becomes a misprediction. Rattee J in *Regalian Properties*¹⁵⁹ attempted to draw a fine line between a mere misprediction and the situation in *William Lacey*. In *Regalian Properties* the defendant (LDDC) invited tenders for the development of land. Regalian Properties submitted a tender and LDDC accepted their tender 'subject to contract'. The fluctuations in the property market and other difficulties forced LDDC to re-evaluate the terms on which they were willing to contract. The parties were unable to agree on new terms and Regalian Properties brought a claim for the fees that had been paid to professionals with regard to the development. Rattee J considered the judgment in *William Lacey* and found that the facts could be distinguished. In *William Lacey* the court had found that a separate agreement for the preparation of the estimates had been formed. In this case LDDC had not unilaterally decided to abandon the project, as was the case in *William Lacey*, but that there was a genuine disagreement on the price. Rattee J explained that '*each party to such negotiations must be taken to know [...] that pending the conclusion of a binding contract any cost incurred by him in preparation for the intended contract will be incurred at his own risk.*'¹⁶⁰ A further element of the decision was the fact

¹⁵⁸ *William Lacey (Hounslow) Ltd v Davis* [1957] 1 WLR 923 (QB), 939.

¹⁵⁹ *Regalian Properties Plc v London Docklands Development Corp* [1995] 1 WLR 212 (CD).

¹⁶⁰ *Ibid.* p.231.

that the copyright in the material that had been created by Regalian Properties did not pass to LDDC and for this reason the judge was unable to find an enrichment.

Prior to *Regalian Properties*, in 1953, the case of *Brewer Street Investments*¹⁶¹ had reached the Court of Appeal. A prospective tenant had requested alterations to be made to the claimant's property in anticipation of the tenancy agreement being signed. However, the negotiations broke down because the defendant requested an option to purchase at the end of the tenancy, which the claimant was not willing to give. The Court of Appeal held that the defendant was liable for the changes on a restitutionary basis. Lord Denning asked on whom the risk should fall in such a case and concluded that the risk should lie with the defendant.¹⁶² Somervell L.J. held that due to the '*defendants own course of conduct*'¹⁶³ the negotiations had broken down and for that reason the risk should fall to the defendant.

This decision is difficult to reconcile with the requirement of enrichment put forward by Rattee J in *Regalian Properties*.¹⁶⁴ However, both parties had confidently believed that a contract would come about and Barclays Woollen (the defendant in *Brewer Street Investments*¹⁶⁵) had requested the work to start even though they were not yet willing to agree on the terms the claimant had put forward. The fact that the loss occurred, upon the defendant's request, was sufficient to remove the

¹⁶¹ *Brewer Street Investments Ltd v Barclays Woollen Co Ltd* [1954] 1 QB 428 (CA).

¹⁶² *Ibid.* at 436.

¹⁶³ *Ibid.* at 434.

¹⁶⁴ *Regalian Properties Plc v London Docklands Development Corp* [1995] 1 WLR 212 (CD).

¹⁶⁵ *Brewer Street Investments Ltd v Barclays Woollen Co Ltd* [1954] 1 QB 428 (CA).

presumption of the fault for the loss from Brewer Street Investments to Barclays Woollen. It would seem, at least from the unjust enrichment cases, that apart from *Brewer Street*¹⁶⁶, damages will not be awarded for the claimant's loss but if there has been a gain to the defendant then, permitting it was due to their fault, there will be restitution for the defendant.

The German approach to restitution

Above it was identified that *culpa in contrahendo* was used in cases¹⁶⁷ where one party broke off negotiations for no good reason after leading the other party to believe that a contract would ensue. After encouraging the other party to incur a loss, a better offer from a competitor would not be sufficient. Though assuming that there was no culpa because the other party had a good reason to break off negotiations (a significant change in the market for example) the German courts may have to fall back on the law of restitution covered by § 812 (1) BGB:

A person who, through an act performed by another, or in any other manner, acquires something at the expense of the latter without any legal ground, is bound to return it to him. This obligation subsists even if the legal ground subsequently disappears or the result intended to be produced by an act to be performed pursuant to the legal transaction is not produced.

In cases therefore where one party has partly or wholly performed their side of the agreement in anticipation of a contract, § 812 BGB would require the items to be

¹⁶⁶ Ibid.

¹⁶⁷ Which is now covered by §§ 311 and 242 BGB

returned.¹⁶⁸ The approach, though different in execution, is similar to the English approach even if it is used in fewer cases than the English approach due to the nature of §§ 311 and 242 BGB. This means that both jurisdictions have a minimum protection against one of the parties gaining from the other's 'wrongful' acts.

Preliminary conclusions

It is argued that in the English case it is as if damages are awarded on reliance basis rather than there being restitution. This would bring them closer to the German approach than one may have originally expected. However, overall it would still seem that *British Steel* is the approach that would be taken by the courts, namely that once the delivery has been made there is a gain to the defendant and that gain should be returned. Were the steel nodes never delivered then the defendant would never have been enriched and there would be no claim in restitution. The second point to remember is that there is a limitation on claims in restitution, namely when the result would be contrary to statutory provisions (though these cases are very limited because it seems that there are few statutory provisions that would contradict that) or when it is generally considered as 'part of the risk'.¹⁶⁹

The same approach applies in the German cases though the principle of restitution is applied in far fewer cases due to the principle of *culpa in contrahendo*.¹⁷⁰ The

¹⁶⁸ Though there is a limitation through § 814, where the party knew that there was no contract, hence the need to fall back on §§ 311 and 242 BGB.

¹⁶⁹ See for example *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669 (HL) (previously discussed in FN 153).

¹⁷⁰ See above on the argument of enrichment as opposed to loss (CH 3.04).

conclusion that can be drawn here is that both systems provide a minimum protection against gain through blameworthy behaviour at the negotiation stage. However, this principle is limited in cases by the protection of the statutory provisions.¹⁷¹

The exception here though is provided by *Way v Latilla*,¹⁷² though this may be dependent on the facts, it shows that the English courts would be willing to limit the freedom from contract, namely holding that there was a contract even though the parties had not agreed on a price, when the German court would not.¹⁷³

3.05 No real intention to contract

The next scenario involves A leading B to believe that they may enter into a contract. However, A never had an intention to enter into the contract and later ends the negotiations. In contrast to the unjust enrichment scenario there is now evidence of the intention of the party breaking off the negotiations. From the scenario above it is clear that the minimum recovery for B in both countries lies in restitution. The question is whether B may recover damages.

The German approach to fraud

The main case for breach of duty to bargain in good faith (§§ 280 I; 311 II (1) BGB (*Culpa in contrahendo*), as shown above, is the feigning of serious negotiations. The necessary requirement lies in the '*qualifizierten Vertrauensbestand*' - the qualified

¹⁷¹ Cf. § 817 BGB, where the recipient has breached a statute or good morals.

¹⁷² *Way v Latilla* [1937] 3 All ER 759 (HL).

¹⁷³ Though the German court would probably (in light of § 311 BGB) award reliance damages or would have to fall back on § 632 BGB.

trust relationship. The breach of the trust relationship, i.e. the breaking off of negotiations, leads to compensation on the basis of the negative interest (reliance). One party must have unmistakably led the other party to believe that a contract would certainly be formed and that party's breaking off is seen as a grievous infringement of the duty of honest behaviour.¹⁷⁴ The most common example is intentional misbehaviour.¹⁷⁵ Interestingly, as the liability arises from the intention of the other party not to contract, the liability can arise before the negotiations have even been broken off. This was confirmed by a Court of Appeal¹⁷⁶ in Stuttgart in 2007.¹⁷⁷ The claimant, a Swiss company, entered negotiations for the take-over of company AS. The defendant was the sole shareholder of company O, which in turn was a consultant to company AS. The idea was that a new company, owned by the claimant, was to be founded that would hold all the shares of company AS. Many meetings followed and the claimant drafted the documents, developed business plans and received the confirmation of the bank to support the take-over. The defendant took part in a workshop with company O in which they mainly discussed remuneration of the board of director and the financial planning for the following years. Shortly afterwards company AS sent the claimant an email stating that they were not willing to continue negotiations due to the fact that the defendant was unwilling to participate. The defendant then engaged in negotiations with AS directly and ultimately took over the company. The claimant

¹⁷⁴ Pfister, *Festschrift für Werner Lorenz* (J.C.B. Mohr Tübingen 1991), p. 166.

¹⁷⁵ *BGH NJW 1996, 1885 (Tax Avoidance Case)*.

¹⁷⁶ Oberlandesgericht.

¹⁷⁷ *OLG Stuttgart WM 2007, 1743, 1744 ff.*

asserted that the defendant used the information gathered during the negotiations to further his own interest and always knew that he would be unwilling to contract. The court agreed that if the defendant had always known he was unwilling to contract he would have been liable. However, in this case the evidence¹⁷⁸ – in particular the fact that he had attended the workshop – was sufficient to rebut the claim that he had always known that he would be unwilling to contract.¹⁷⁹

The English approach to fraud

In cases where a statement is made fraudulently, the other party will be liable for the loss that the fraudulent statement caused. A statement is fraudulent if made with knowledge of its falsity, without belief in its truth, or recklessly.¹⁸⁰ In *Derry v Peek*¹⁸¹ the claimant had been induced to buy shares in a company after the directors of the company had made statements in the prospectus to the effect that they would have the right to use steam engines rather than horses on the tram lines – this was seen as a great advantage at the time. The Board of Trade later refused to give their consent to the use of steam and consequently the company went into liquidation. The Court of Appeal held the directors liable on the basis that the directors should have known the statement to be untrue. The House of Lords

¹⁷⁸ No doubt if the information was not publicly available he could also have been liable for misuse of confidential information. This applies to both the German and the English cases. For more information see Beale and others, *Contract Law: lus Commune Casebooks for Common Law of Europe* (2nd edn, Hart Publishing 2010), p.425, 426.

¹⁷⁹ See also the hypothetical case discussed in Zimmermann and Whittaker, *Good Faith in European Contract Law* (Cambridge University Press 2000), p.236-238.

¹⁸⁰ *Derry v Peek* [1889] 14 App Cas 337 (HL), 374.

¹⁸¹ Ibid.

reversed the judgment and held that due to the fact that the directors honestly believed the statement to be true based on the belief that the consent of the board of traders was virtually certain, there was no ground for a claim in fraud.¹⁸² By contrast, in *Brown Jenkinson*¹⁸³ the claimant, on the request of the defendant, had issued a clean bill of lading (even though they knew that the goods were in bad condition). When the goods arrived damaged the claimants attempted to rely on the indemnity given by the defendant against their loss. The Court of Appeal held that as the claimants had issued a clean bill of lading with the intention that it would be relied on, the requirements for a claim in the tort of deceit were fulfilled (and therefore the indemnity was illegal and could not be relied on). There was no need to show that the claimant intended to cause any loss.

Fraud therefore requires the intention to deceive the other party followed by some sort of positive representation. Anything less than a deliberate or reckless act could only amount to negligent or innocent misrepresentation (see ch 3.08 on 'negligently misleading'). A claim in deceit is commonly brought to provide the claimant with a remedy in cases where he has been induced into a contract through the misrepresentation of the defendant. It is not limited to such scenarios, as shown below, and the claimant will be able to rely on the tort of deceit so long as he can show, as Cotton L.J. expressed in *Arkwright v Newbould*¹⁸⁴, that the defendant has made a statement to be acted upon by others which is false, and

¹⁸² Ibid. at 379.

¹⁸³ *Brown Jenkinson & Co Ltd v Percy Dalton (London) Ltd* [1957] 2 QB 621 (CA).

¹⁸⁴ *Arkwright v Newbould* [1881] 17 Ch D 301 (CA).

which is known by him to be false, or is made by him recklessly, or without care whether it is true or false, that is without any reasonable ground for believing it to be true. The requirement is therefore not that the claimant must prove that the defendant intended to cause a loss but he must prove an intention to deceive.¹⁸⁵ Whilst *Derry v Peek*¹⁸⁶ involved the inducement into a contract this does not limit the scope of deceit to cases in which a contract has ensued. *Richardson v Silvester*¹⁸⁷ addressed a misrepresentation at the pre-contractual stage where no contract came into existence. The defendant had publicly advertised for the letting of a farm and the claimant, on the basis of the advertisement, incurred expenses inspecting and valuing the premises. It then became apparent that the defendant never had the power to let the property and had advertised the property 'to serve some purpose of his own'.¹⁸⁸ The court held that the claimant had been deceived.

In the American case of *Markov v ABC Transfer & Storage Co*¹⁸⁹ the lessor of a warehouse misrepresented to the lessee that the lease would be renewed for a further three years even though he had an intention to sell the property. The property was sold and the lessee, due to the fact that he had to move on short notice, lost an important customer. The court held that this would have not occurred had the lessor not deceived the lessee and awarded the lessee damages

¹⁸⁵ *Derry v Peek* [1889] 14 App Cas 337 (HL), 374 per Lord Herschell.

¹⁸⁶ *Ibid.*

¹⁸⁷ *Richardson v Silvester* [1873-74] LR 9 QB 34 (QB).

¹⁸⁸ *Ibid.* at 34.

¹⁸⁹ *Markov v ABC Transfer & Storage CO.* [1969] 76 Wn 2d 388 457 p 2d 535 (SC).

for the increase in cost for having to move at short notice and damages for the lost profits from one of their large clients which they would have otherwise retained.

It would seem also that in cases in which the defendant represents to the claimant that he intends to contract and he honestly holds that belief¹⁹⁰, he is free to change his mind. However, upon the change of mind he has a duty to inform the defendant. In cases where he fails to inform, a case of fraudulent misrepresentation may arise. In *Slough Estates*¹⁹¹ the claimant was granted permission by the local council to develop a site. A third party soon obtained planning permission for a different site only three miles away for a similar development and the claimant did not believe that both could be run profitably. The defendant assured the claimant that a tenancy mix agreement would be enforced by the council against C which would reduce the competition to the claimant. Later the council and the third party entered into a secret agreement that the terms of the tenancy mix agreement would be relaxed but continued to represent to the claimant that the agreement was still in force. The claimant therefore alleged that there had been a fraudulent misrepresentation and the court agreed that there was a misrepresentation from the time that the decision was made to relax the terms of the agreement and the claimant had not been informed.

¹⁹⁰ Otherwise there would be grounds for a case in fraudulent misrepresentation: *East v Maurer* [1991] 1 WLR 461 (CA).

¹⁹¹ *Slough Estates Plc v Welwyn Hatfield DC* [1996] 2 PLR 50 (QB).

Preliminary conclusions

Both systems provide a remedy where A has deliberately misled B as to his intention to contract. While the German courts base their decision on the misuse of trust placed in the defendant,¹⁹² the English courts base their decision on the dishonesty of the defendant. Essentially though, the values in both system are the same, namely the protection of the claimant against intentional (and reckless) dishonesty at the pre-contractual stage that causes loss. This adds to the section of unjust enrichment in that there the claimant will only be able to recover the gain to the defendant whereas in this case the claimant will be entitled to all his loss naturally flowing from the fraud.

¹⁹² E.g. BGHZ 76, 343 (*Failed Shopping Centre Case*), 349, confirming BGHZ 71, 386, 395. This case will be discussed in more detail in Ch. 3.11.

3.06 Negligently misleading

A case was decided in the High Court which despite the absence of fraud still found liability on a tortious basis.¹⁹³ In *Box v Midland Bank*¹⁹⁴ the manager of a bank had assured the owner of a pylon factory that a credit would be forthcoming ('a simple formality'). The application was later refused by the head-office and the bank argued that their manager had expressed no more than his opinion on the matter. However, Lloyd J held that '*the distinction between fact and opinion has become less important since the decision [...] in Esso Petroleum Co Ltd v Mardon*¹⁹⁵.'¹⁹⁶ The manager's representation as to the existing policy with regard to applications was a statement of fact. It must be noted that *Box v Midland Bank* is still an isolated

¹⁹³ There are some obvious advantages to a claim in fraudulent misrepresentation in contrast to a claim in negligent misrepresentation in that the claimant will not have to prove a special relationship or that the defendant had superior skill or knowledge. The claimant will also be able to recover all his consequential losses flowing from the deceit. In *Doyle v Olby (Ironmongers) Ltd* [1969] 2 QB 158 (CA) (at 166) Lord Denning held that the '*amount should not be limited to losses which are foreseeable but to repair the actual damage flowing directly from the fraudulent inducement.*' This also extends to the loss of opportunity (*East v Maurer* [1991] 1 WLR 461 (CA)) which would apply in cases in which the defendant had entered into negotiations with the claimant in order to avoid him entering into a contract with a third party (See for example the American case of *Markov v ABC Transfer & Storage CO.* [1969] 76 Wn 2d 388 457 p 2d 535 (SC)). If the claimant were then able to show that the defendant never intended to enter into the contract, he would be able to claim for the lost opportunity of the contract with the third party.

¹⁹⁴ *William Reginald Box v Midland Bank Ltd* [1981] 1 Lloyd's Rep 434 (CA).

¹⁹⁵ *Esso Petroleum Co Ltd v Mardon* [1976] QB 801 (CA) .

¹⁹⁶ *William Reginald Box v Midland Bank Ltd* [1979] 2 Lloyds Rep 391, 399.

case¹⁹⁷ which is yet to be followed by the Supreme Court but it shows that the courts are willing to find liability at the pre-contractual stage about the willingness of the party to enter into a contract on the basis of negligent misrepresentations.

3.07 Change of mind

In the previous cases the assumption was always that there was some form of misrepresentation in that one party was being strung along although the other had no intention or was in some way unaware that the other had no intention of concluding a contract. In contrast, this section analyses the scenario where A has every intention to contract with B and therefore enters the negotiations. B incurs a loss in anticipation of the contract. However, A then changes his mind (without immediately informing B) and later breaks off the negotiations.

The German Approach

German law allows for the parties to break off negotiations or even to change their minds during the negotiations.¹⁹⁸ This is the parties' freedom of contract.¹⁹⁹ However, this freedom is limited by a general duty not to break off negotiations

¹⁹⁷ A search of Westlaw (13.05.2012) proved that the case had only been cited in three reported cases.

¹⁹⁸ Markesinis, Unberath and Johnston, *The German Law of Contract: A Comparative Treatise* (2nd edn, Hart Publishing 2006), p. 99.

¹⁹⁹ Ibid. p.100. See also the discussion of freedom of contract in Ch.2.

without a good reason²⁰⁰ and once the good reason has arisen there is a duty to inform the other party that there has been a change of mind.²⁰¹

The difference a delay could make is best shown by the following hypothetical case: A, the builder of a shopping mall, enters into negotiations with B, the owner of a large chain of stores. B sends A plans of the work to be done to the shopping mall in order to meet their specifications and despite not having a signed contract, A starts work. Up to this point, as long as B still intends to contract and there has been no encouragement by B to start the work there is no liability. No contract has come into existence as the parties have to have agreed all material terms for there to even be an agreement to agree (*pactum de contrahendo*).²⁰²

B then hears of a different shopping mall being built in the area and knows that he will not be able to build a store in both locations. B therefore decides to contract with the other shopping mall but does not inform A. The '*vorvertragliches Schutzverhaeltnis*'- the pre-contractual duty to protect the interests of the other party - that was created by the taking up of the serious negotiations allows for the breaking off of negotiations as long as there is a good reason. A better offer, or in this case a better location, would be classed as a good reason. However, the fact that he did not inform A when he changed his mind is classed as a breach of the

²⁰⁰ Bassenge and others, *Palandt- Bürgerliches Gesetzbuch* (74th edn, C. H. Beck Verlag 2015), §311 RN 30-34.

²⁰¹ *Ibid*, §311 RN 30-34.

²⁰² Cartwright and Hesselink, *Precontractual Liability in European Private Law* (Cambridge University Press 2011), p. 93-113.

pre-contractual duties²⁰³ - there is a breach of the duty to bargain in good faith (§§ 280 (1); 311 (2) (1) BGB). The breach and consequently the liability under *culpa in contrahendo*, therefore, is the feigning of serious negotiations after he changed his mind.²⁰⁴

Above it was shown that feigning of serious negotiations was the culpable act that gave rise to liability, in the hypothetical case it is the actual breaking off which provides the grounds for liability. Even though A may have informed B of his change of mind within a reasonable time (so as to comply with a)), he is unable to provide a reason for the breaking off. The threshold for a good reason is not high, however, and so a claim in this category is hard to find.²⁰⁵ This was confirmed by the Court of Appeal in Hamm which was presented with a case in which a producer had negotiated with a band. The producer spent a considerable amount on advertising material and the band was aware of this. In the end the negotiations failed on the basis of objective differences of opinion about the composition of the band. The court held that this was sufficient reason to not trigger liability.²⁰⁶ The court put forward a similar reason in the *Swiss Take-Over Case*.²⁰⁷ The fact that the consultant

²⁰³ 'Aus ihr folgt gleichermaßen die Verpflichtung, den Partner vor einem Irrtum über den (Fort-) Bestand einer geäußerten, tatsächlich aber nicht (mehr) vorhandenen endgültigen Abschlussbereitschaft zu bestimmen Bedingungen zu bewahren'. (BGH NJW 1996, 1884).

²⁰⁴ See the similar case in Cartwright and Hesselink, *Precontractual Liability in European Private Law* (Cambridge University Press 2011), p. 64.

²⁰⁵ Bassenge and others, *Palandt- Bürgerliches Gesetzbuch* (74th edn, C. H. Beck Verlag 2015), §311 RN 32.

²⁰⁶ OLG Hamm NJW 2008 764 , 766.

²⁰⁷ OLG Stuttgart WM 2007, 1743

wanted to take over the company, despite being directly involved, was sufficient to remove any liability from the company.

An extensive search of the main German commentaries in fact and relevant cases revealed only one case where there seems to have been a change of mind which the court may have was not based on sufficient reason. In the *Failed Shopping Centre Case*²⁰⁸ the local authority promised that a building permit would be issued if the claimant could produce a guarantee for 1.5M DM. The local authority then changed their mind and asked for a guarantee of 4.5M DM. The claimant alleged that the additional 3MDM were entirely exaggerated. The German Supreme Court referred the case back to the Court of Appeal on the basis that the Court of Appeal was to decide whether the increase of 4.5M DM was justified or merely a reason that had been put forward to mask the fact that the local authority had changed their mind without a good reason.²⁰⁹ As this is the only decision which indicates that the local authority may have been successful on this basis, it seems that the balance is tipped, in this case, towards freedom of contract rather than in favour of the protection of the trust (or reasonable expectations) in the relationship of the parties.

²⁰⁸ BGHZ 76, 343 (*Failed Shopping Centre Case*) .

²⁰⁹ Ibid. p. 351.

The English Approach

Promissory Estoppel

The principle of promissory estoppel as developed by Denning LJ in the case of *High Trees*²¹⁰ prevents a party from going back on a promise, even though that promise had not been backed up by consideration, so long as the promise was clear and unequivocal.²¹¹ However, promissory estoppel can only be used as a sword and not a shield which means that in the cases of breaking off negotiations (where there is no previous contractual relation) promissory estoppel would not apply.

Nevertheless, the Australian case of *Waltons Store v Maher*²¹² involved negotiations in which Maher started preparatory building work. Walton Stores had indicated that the contract would certainly come about. Maher began building work on the project of which Walton Stores became aware just a few weeks after they had given their oral assurance. Walton Stores then had a change of heart and instructed their lawyers to 'go slow' until they broke off the negotiations completely. By this time about 40 per cent of the building work had been completed. The Australian courts found that Walton Stores were estopped from going back on their promise, using estoppel as a cause of action in itself. It is particularly interesting that Mason CJ and Wilson J considered the objection that the use of promissory estoppel in this way could outflank the doctrine of consideration. However, they both took the view that

²¹⁰ *Central London Property Trust Ltd v High Trees House Ltd* [1947] KB 130 (KB).

²¹¹ Per Hailsham L.J. in *Woodhouse AC Israel Cocoa SA v Nigerian Produce Marketing Co Ltd* [1972] AC 741 (HL).

²¹² *Waltons Stores (Interstate) Ltd v Maher* [1988] 164 CLR 387 (HC).

the element of unconscionability in estoppel was a sufficiently distinguishing feature. The court therefore held that exchange of contracts had in fact taken place (i.e. they were estopped from denying that contracts had been exchanged).²¹³ The Australian case shows that it is possible to use promissory estoppel in cases where a party changes their mind and does not mention that change of mind to the other party.²¹⁴ However, the English courts have rejected the principle of allowing promissory estoppel²¹⁵ to provide the basis of a claim and it seems unlikely that this approach is going to change.²¹⁶

The conclusion that can be drawn at this point is that the German and English approach in cases where the negotiations were broken off because A changed their mind is different (though there is evidence that the same problem has been treated differently in Australia which means that the common law system would have the capability of following a similar approach to that of the German system by using promissory estoppel but has deliberately opted not to). There is an additional route that the English courts may be able to take in cases where the party has changed their mind, namely negligence liability. In *Box v Midland Bank*²¹⁷ the bank manager knew (or should have at least known) from the beginning that the loan would not

²¹³ Ibid. p. 446.

²¹⁴ See also though the cases of *Valbirn Pty Ltd v Powprop Pty Ltd* [1991] 1 Qd R 295 (SC) and *Sabemo Pty Ltd v North Sydney Municipal Council* [1977] 2 NSWLR 880.

²¹⁵ *Combe v Combe* [1951] 2 KB 215 (CA), though it may form the basis of a claim in Proprietary Estoppel (*Wayling v Jones* [1995] 69 P & CR 170 (CA)); also see below at Ch. 3.09 and Ch. 3.10

²¹⁶ *Baird Textile Holdings Ltd v Marks & Spencer Plc* [2001] CLC 999.

²¹⁷ *William Reginald Box v Midland Bank Ltd* [1981] 1 Lloyd's Rep 434 (CA).

be approved by the head office. It may be possible to apply the reasoning in *Box v Midland Bank* by analogy to a case the change of mind scenarios mentioned above. The liability would have to arise from the fact that the person that had changed their mind had not informed the other party of their decision. However, a difficulty is that in *Box v Midland Bank* the manager seems to have known or should have known from the beginning (i.e. they should have known better) which is different to a scenario where they did not know any better when they entered negotiations but had a change of heart later. Several writers have expressed their doubt about the future of *Box v Midland Bank* mainly because it flies in the face of the English approach to look after one's own interests and not those of another.²¹⁸ Further there is also the general hostility of English courts towards claims for pure economic loss²¹⁹ and also the fact that, as mentioned above, this would limit the freedom of contract as an English concept.²²⁰ There is even more hostility to pure economic loss in Germany,²²¹ however, this seems to be justified on the basis that this can be circumvented through the use of § 311 BGB.

²¹⁸ Markesinis and Deakin, *Tort Law* (4th edn, Oxford: Clarendon Press 1999), at p. 93; Giliker, 'A Role for Tort in Pre-Contractual Negotiations? An Examination of English, French, and Canadian Law' (2003) 52 *The International and Comparative Law Quarterly*, 978.

²¹⁹ Giliker, 'A Role for Tort in Pre-Contractual Negotiations? An Examination of English, French, and Canadian Law' (2003) 52 *The International and Comparative Law Quarterly*, 978.

²²⁰ See Ch. 3.02.

²²¹ See § 823 BGB.

3.08 Changing the terms

The scenario in Ch. 3.07 has already marked a difference in approach but in those cases A in fact broke off the negotiations. In this next scenario A does not end the negotiations. Both A and B are aware that there is no contract yet and B is encouraged to incur a loss. However, then A decides to significantly alter the terms on which they are prepared to contract.

The German Approach

In the *Tax Avoidance Case*²²² the claimant had rented the ground floor of a property and in the summer of 1989 the defendant bought the property and decided to expand the property, divide the property and ultimately sell off the individual parts. In 1991 the plaintiff and defendant entered negotiations for the purchase of the ground floor. The parties agreed on a price of 750.000 DM. The defendant asked for the purchase not to be completed formally until the end of the year for tax reasons and the plaintiff agreed. The plaintiff adapted the property for his use. In December of 1991 the plaintiff approached the defendant to arrange a date to formally complete the purchase at which point the defendant revealed that he would not be willing to sell the property at less than 1 Mil. DM. The court acknowledged that generally until the contract has formally been entered into each party is responsible for their own expenditure.²²³ The defendant argued that the requirement of form had not been fulfilled (the requirement under § 313 BGB). The court held though that by assuring the other party that they would enter into the

²²² BGH NJW 1996, 1885 (*Tax Avoidance Case*).

²²³ With reference to BGH NJW-RR 1989, 627 ..

contract, that party could not rely on the requirement of form because this would be contrary to good faith and so in effect gave way to the contract. The argument here is that this is a further example of balancing several values. The first is the liability for blameworthy conduct in a contractual context (in this case it is the promise that a contract will ensue on specific terms). The second principle is to protect the provisions of the BGB in this case the requirement of form (§ 313 BGB) which in itself is limited by the protection against misuse of those provisions contrary to good faith. The court concluded here that the fact that the defendant had put the plaintiff into a position of higher risk of incurring a loss (through promising to complete the contract) that this justified an increased duty to take into account the interests of the other party.²²⁴ The argument would therefore be that the relationship of the parties creates an obligation to inform the other party that they are mistaken which in itself is a protection of the informal trust, which is the 'blameworthy conduct' which the courts are protecting the plaintiff against.

The English Approach

A similar case to the German case reached the House of Lord in 2008. In *Cobbe v Yeoman's Row*²²⁵, Mr Cobbe, a developer, had been encouraged to incur expenses in obtaining planning permission for a development. A representative of Yeoman's Row had orally agreed that he would obtain planning permission to demolish the building and build a new development. After that Yeoman's Row would sell him the

²²⁴ This argument is particularly prevalent in the mistake cases where culpa in contrahendo creates an obligation to inform the other party of their mistake (see Ch 4.6).

²²⁵ *Cobbe v Yeoman's Row Management Ltd* [2008] UKHL 55.

freehold for a certain price. Both parties were aware that there was no contract in place. Part of the oral agreement was that some of the houses would be sold and that half the proceeds would be handed over. The value of the property increased significantly and Yeoman's Row decided to first ask for £12m upfront and then later demanded £20m upfront. Lord Walker²²⁶ started by expressing that proprietary estoppel is not '*a sort of joker or wild card to be used whenever the court disapproves of the conduct of a litigant who seems to have the law on his side*'²²⁷ and went on to explain that such an approach would impair the certainty of such transactions.²²⁸ The judgment in *Cobbe* shows that the facts that the claimant knew of the nature of the transaction and had knowledge and experience of the industry²²⁹ and that the agreement was subject to contract precluded him from succeeding in proprietary estoppel.²³⁰ A further difficulty in *Cobbe* was the fact that the terms of the agreement were not clear: '*They reach[ed] an oral agreement in principle*'.²³¹ As with the former doctrine of part performance,²³² for the court to enforce an agreement on the basis of proprietary estoppel, the terms of that

²²⁶ Ibid.

²²⁷ Ibid. at [46].

²²⁸ Ibid. at [81].

²²⁹ '[H]e ran a commercial risk with his eyes open' (*Cobbe v Yeoman's Row Management Ltd* [2008] UKHL 55 at [91]).

²³⁰ Cobbe did not leave with empty hands which would have left the defendant unjustly enriched. Cobbe was awarded the *quantum meruit* to cover the value of the services rendered including all the expenses he had reasonably incurred.

²³¹ *Cobbe v Yeoman's Row Management Ltd* [2008] UKHL 55 at [2] per Scott of Foscote L.J.

²³² See for example *Harvela Investments Ltd v Royal Trust of Canada (C.I.) Ltd* [1986] AC 207, at 224.

agreement must be clear and unequivocal. This did not preclude the court from awarding damages on a quantum meruit basis for unjust enrichment though.

The judgment in *Cobbe* was followed by the recent case of *Haq v Island Homes Housing Association*,²³³ where Mr Haq had agreed with the Council, subject to contract, that he could extend his shop onto the Council's neighbouring land. The signing of the document was delayed and the Council allowed Haq to enter the land (by handing over the keys) and extend his property, which he did. The agreement went through several stages with several meetings, making minor amendments to the draft contract and requesting different plans. Mr Haq was allowed access to the property and started building work on the property. The Council knew of the building work and noticed that some elements of the work did not conform with the plans that had been submitted. Three years after the draft contract had been created the council sent Mr Haq the draft documents but failed to execute them. Half a year later the Council sold the property to a housing association who were unwilling to extend the lease on the terms that had been manifested in the draft contract. The court had no difficulty in finding that the council had led Mr Haq to believe that the documents would be executed²³⁴ but found that no belief had been created that the lease had already been granted.²³⁵ The fact that Mr Haq was never under the belief that there was no need for the signing of the documents ensured

²³³ *Haq v Island Homes Housing Association* [2011] EWCA Civ 805 (CA).

²³⁴ *Ibid.* at [48].

²³⁵ *Ibid.* at [50].

that there was no claim in proprietary estoppel.²³⁶ The fact that the council allowed access to the grounds to extend the property was held to be nothing more than a temporary licence and '*it did not, by the same conduct, waive the requirement that the documents should eventually be signed and exchanged, when they were agreed in their final form*'.²³⁷ This judgment falls in line with Lord Scott's dicta in *Cobbe* that '*Mr Cobbe did not spend his money and time [...] in the mistaken belief that the agreement was legally enforceable. He spent his money and time well aware that it is not.*'²³⁸

However, in the American case of *Hoffman v Red Owl Stores*,²³⁹ where Red Owl Stores encouraged Hoffmann to sell his bakery (and confirmed that the amount he had put aside for the franchise was sufficient), later increased the price which lead to the negotiations coming to an end. Particularly interesting in this case is that the court only awarded reliance damages. In fact, at Ch. 3.07 it was suggested that in cases where one party changes their mind during negotiations it may be worth considering negligent misrepresentation.²⁴⁰ In response to *Hofmann v Red Owl Stores*²⁴¹ it has been suggested that this may have been a more appropriate

²³⁶ Ibid at [73] and [83] per Lord Lloyd.

²³⁷ Ibid. at [71].

²³⁸ *Cobbe v Yeoman's Row Management Ltd* [2008] UKHL 55 at [27].

²³⁹ *Hoffman v. Red Owl Stores, Inc.*, 26 Wis2d 683, 133 NW2d 267 (1965).

²⁴⁰ By analogy to *William Reginald Box v Midland Bank Ltd* [1981] 1 Lloyd's Rep 434 (CA).

²⁴¹ *Hoffman v. Red Owl Stores, Inc.*, 26 Wis2d 683, 133 NW2d 267 (1965).

response than to rely on promissory estoppel.²⁴² In fact the result would have on the facts been exactly the same. The conclusion that can be drawn at this stage is that the English approach is much narrower where the other party knows that the form has not been complied with.²⁴³ Although promissory estoppel is unlikely to be taken by the English courts there is some argument to be made that the same result to *Hoffmann v Red Owl Stores* could be achieved through analogy with *Box v Midland Bank*.²⁴⁴ What can be seen from the above is that the English courts recognise fault-based liability to a certain extent (Ch. 3.05, 3.06, 3.07). The difference in relation to the German approach seems to be a different understanding of what in fact constitutes fault. In the English cases liability is based on fraud or negligent misrepresentation which is then limited by the fact that the English courts are reluctant to impose liability for economic loss. In contrast the German system is starting from the point of view that there is a duty to avoid harm to the other and breach of that duty is then considered 'fault'. The next section will draw on parallels between the systems where it would seem that the parties have reached agreement but have not (for various reasons) fulfilled the statutory requirements of form.

²⁴² Feinman, 'The Last Promissory Estoppel Article' (1992) 61 Fordham Law Review 303, 315:

'Hoffman can hardly be understood on the basis of promissory estoppel doctrine[...]. [I]t may be better understood as a tort case involving negligent misrepresentation of a peculiar kind.'

²⁴³ For a discussion of *Cobbe v Yeoman's Row Management Ltd* [2008] UKHL 55 see Goymour, 'Cobbling Together Claims where a Contract Fails to Materialise' (2009) 68 The Cambridge Law Journal 37.

²⁴⁴ *William Reginald Box v Midland Bank Ltd* [1981] 1 Lloyd's Rep 434 (CA).

3.09 The Noblemen

This scenario is rather similar to the above in that both parties are aware that they have not entered into a contract yet. However, the reason for not doing so is because A has persuaded B that there is no need to formally enter into a contract because they are noblemen.

The German Approach

In the *Christmas Bonus case*²⁴⁵ the claimant lived in a house rent-free as part of his remuneration as an employee. On two occasions the defendant confirmed that as a Christmas bonus the house would be conveyed to him. He assured him 'upon his word as a nobleman' and that any notarial conveyance was unnecessary. The former German Supreme Court held in favour of the defendant. The reasoning was that the claimant knew what formalities were necessary and should have known better than to rely on 'a nobleman's word'.

German courts clearly distinguish between the case where knowledge of formal requirements is present but one party misleads the other into believing the requirements have been fulfilled and the situation where despite knowledge of the need for formal requirements one party believes and trusts the other that it will eventually be taken care of. The difference in approach represents the courts balancing of the parties' interests as opposed to the purpose of the statutory provisions, which is to provide certainty, particularly in relation to the sale of land. It is for this reason that the actual agreement will only be enforced (contrary to the

²⁴⁵ RGZ 117, 121 .

statutory requirements of §§ 313; 125 BGB) if the result would otherwise be totally unbearable. The threshold for being totally unbearable is high in that it must destroy or substantially threaten the existence of the party, or the other party must have gravely offended against the principle of good faith.²⁴⁶ This, however, does not eliminate a claim for enrichment under § 812 I 1 BGB.²⁴⁷

The English Approach

The English approach must again refer to *Cobbe v Yeoman's Row*²⁴⁸ (see above Ch. 3.08). B's knowledge that there is no contract is lethal to a claim in proprietary estoppel though there is still the possibility of recovery for unjust enrichment (see Ch. 3.04 above).

3.10 Form

The noblemen scenario showed that there was a similar approach taken in the German and English courts in cases where they know that there is a form requirement and agree not to comply. However, the case is different when A leads B to believe that there is no form requirement at all (and B is unaware of the requirement).

The German approach

A case came before the German courts in 1965 where a couple had signed a document explaining the detailed plans for a house and the way in which the

²⁴⁶ See BGHZ 85, 315, 318 f. in Zimmermann and Whittaker, *Good Faith in European Contract Law* (Cambridge University Press 2000), p. 259.

²⁴⁷ Note also § 818 II BGB.

²⁴⁸ *Cobbe v Yeoman's Row Management Ltd* [2008] UKHL 55.

property was to be financed.²⁴⁹ The document also contained a provision which stated that on completion of the building the agreement was to be transferred into a legally binding contract for the sale of the property. This was never done and the defendant attempted to evade liability by relying on the lack of form. The court held that the couple had been induced to sign a contract that they believed contained all the valid clauses. The developers on the other hand were, or should have been, aware of the fact that the document had no legal force and therefore had a pre-contractual duty to inform the couple about the absence of statutory or contractual form for the contract.²⁵⁰ Rather than finding that a contract existed the courts therefore found that there was a requirement to inform and that this requirement then provided a possibility to circumvent the requirement of form.²⁵¹ If the buyer is therefore ignorant to the requirements of form and the seller is held to have the knowledge of the requirement, then the seller has a duty to inform the buyer.²⁵² Generally, breach of a pre-contractual duty leads to compensation on a

²⁴⁹ *BGH NJW 1965, 812* ; see also *BGHZ 6, 330* and *BGHZ 18, 248* .

²⁵⁰ *BGH NJW 1965, 812* , 814.

²⁵¹ This has also been applied to cases where the other party knew that the contract was illegal. See *BGHZ 99, 101* for a translation of the case see Markesinis, Unberath and Johnston, *The German Law of Contract: A Comparative Treatise* (2nd edn, Hart Publishing 2006), p.605 (Case 27).

²⁵² Note that pre-contractual duties of disclosure will be discussed in more detail in Ch. 4.06.

reliance basis.²⁵³ However, there may be liability on a tortious basis (§ 826 BGB) which will also lead to liability for pure economic loss.²⁵⁴

The English Approach

The problem of s. 2 of the Law of Property Act 1989 (LPA 1989)

The Law of Property (Miscellaneous Provisions) Act 1989 s. 2 replaced the Law of Property Act 1925 s. 40 as of September 1989. Previously contracts for the sale of land that were not supported by writing were enforceable if there had been 'part performance'. The principle of part performance meant that if the claimant had started performing their side of an oral contract in the expectation that the defendant would perform their side of the agreement, the court would not allow the defendant to avoid his liability of the agreement merely on the basis of the statute and would order specific performance,²⁵⁵ giving way to the original contract. For example, in *Steadman v Steadman*²⁵⁶ a payment made by the husband to his wife of £100 arrears of maintenance was held to be sufficient to be part performance of an oral contract that the wife would transfer an interest in the matrimonial home. However, mere preparatory arrangements in view of a contract

²⁵³ For a differentiation of the two see *BGHZ 99, 101* for a translation of the case see Markesinis, Unberath and Johnston, *The German Law of Contract: A Comparative Treatise* (2nd edn, Hart Publishing 2006), p.605 (Case 27).

²⁵⁴ However, the threshold is very high. See Markesinis, Unberath and Johnston, *The German Law of Contract: A Comparative Treatise* (2nd edn, Hart Publishing 2006), p.99.

²⁵⁵ *Dickenson v Barrow Dickinson v Barrow* [1904] 2 Ch 339 (CD); *Rawlinson v Ames Rawlinson v Ames* [1925] Ch 96 (CD) .

²⁵⁶ *Steadman v Steadman Steadman v Steadman* [1976] AC 536 (HL).

are insufficient to give rise to part performance.²⁵⁷ The doctrine of part performance seems to therefore have been developed to provide the courts with the ability to give way to justice in cases in which the defendant was attempting to rely on the 1925 Act in order to escape the bargain he had struck.²⁵⁸

The Law Commission reviewed the law on the formalities for contracts for the sale of land which lead to the Law of Property (Miscellaneous Provisions) Act 1989.²⁵⁹ The Law Commission decided that the doctrine of part performance had become 'very confused'²⁶⁰ and that the doctrine was to be abolished due to the fact that estoppel and the law on negligent/ fraudulent misrepresentation were appropriate remedies.²⁶¹ Although s. 2 LP (MP) A 1989²⁶² actually abolishes the doctrine of part performance, the Law Commission found that it was inherent in the requirement for the contract to be in writing and this has been followed by the courts.²⁶³ The current state therefore is that s. 2 (1) of the 1989 Act can only be circumvented if it falls within s. 2 (5) of the 1989 Act - on the basis of a collateral contract,

²⁵⁷ *Clerk v Wright* [1737] 1 Atk 12 (CC); *Cooth v Jackson* [1801] 6 Ves Jr 12 (CC); *Daulia Ltd v Four Millbank Nominees Ltd* [1978] Ch 231 (CA).

²⁵⁸ Per Lord Reid in *Steadman v Steadman* [1976] AC 536 (HL), at 561.

²⁵⁹ Commission, *Transfer of Land: Formalities for Contracts for Sale etc. of Land* (Law Com No 164, 1987).

²⁶⁰ *Ibid.* at 5.4.

²⁶¹ *Ibid.* at 5.5.

²⁶² Law of Property (Miscellaneous Provisions) Act 1989.

²⁶³ See *Singh v Beggs* [1996] 71 P & CR 120 (CA).

constructive trust or equitable estoppel - which has given rise to an increase in recent case law.

The question of whether proprietary estoppel could be used to avoid s. 2 (1) of the 1989 Act was first raised in *Yaxley v Gotts*²⁶⁴. Here it was argued that according to Halsbury's Laws²⁶⁵ *'the doctrine of estoppel may not be invoked to render valid a transaction which the legislature has, on grounds of general public policy, enacted is to be invalid [...]'*. Beldam L.J., chairman of the Law Commission which had made the recommendations for the changes to the Act, explained that [...] *the general principle that a party cannot rely on an estoppel in the face of a statute depends upon the nature of the enactment, the purpose of the provision and the social policy behind it[...]*²⁶⁶ and that therefore proprietary estoppel is not caught by s. 2 of the 1989 Act. Walker L.J. in the same judgment found a constructive trust rather than addressing the issue of proprietary estoppel. Walker L.J. also held that in light of *Gissing v Gissing*²⁶⁷ the *'two concepts coincide [...] in the area of a joint enterprise for the acquisition of land'*, meaning the concept of constructive trust and proprietary estoppel. The judges therefore agree that due to the close link between constructive trusts and the doctrine of proprietary estoppel, proprietary estoppel is included in the exceptions listed in s. 2 (5) of the 1989 Act.

²⁶⁴ *Yaxley v Gotts* [2000] Ch 162 (CA) .

²⁶⁵ *Halsbury's Laws*, vol 16 (4th edn), para 962.

²⁶⁶ *Ibid* at 191.

²⁶⁷ *Gissing v Gissing* [1971] AC 886 (CA).

Proprietary Estoppel

With the requirement of form cases it must be assumed that the form relates to an interest in land and therefore proprietary estoppel may apply.²⁶⁸ There are two circumstances in which the doctrine of proprietary estoppel may take effect. The first is in cases of ‘acquiescence’, where the claimant is under a mistaken belief that he has an interest in the land and the landowner encourages his belief or stands by²⁶⁹ in the knowledge that the claimant is mistaken.²⁷⁰ The mistake has therefore arisen from the claimant himself. In the second situation the defendant encourages by his conduct²⁷¹ or representation,²⁷² with the intention that the claimant would rely on it,²⁷³ the belief in the claimant that he has or will have a legally enforceable interest in the land. The belief was therefore created by the defendant rather than the claimant.

For a claim in proprietary estoppel to succeed there must also have been a detriment to the claimant. This detriment will often lie in the fact that upon the representation or conduct of the other party the claimant has incurred a cost by,

²⁶⁸ If it does not then the only other possibility would be to look to promissory estoppel – see Ch.

3.07.

²⁶⁹ *Ramsden v Dyson* [1866] LR 1HL 129 (HL).

²⁷⁰ *Willmott v Barber* [1880] 15 Ch D 96 (CD).

²⁷¹ *Thorner v Major* [2009] 1 WLR 776 (HL) (where the promisor was a man of ‘few words’).

²⁷² *Dillwyn v Llewelyn* [1862] 45 ER 1285 (QB).

²⁷³ E.g. *Thorner v Major* [2009] 1 WLR 776 (HL); *Ramsden v Dyson* [1866] LR 1HL 129 (HL).

for example making changes to the property²⁷⁴ or working for the defendant for free.²⁷⁵ Until there has been a detriment to the claimant the representation by the defendant can be revoked,²⁷⁶ eliminating a claim in proprietary estoppel.²⁷⁷

However, that detriment must be substantial, in other words it would be '*unjust or inequitable to allow the assurance to be disregarded*'²⁷⁸ and the court will take into account any benefit the claimant may have derived from the arrangement. In *Henry v Henry*²⁷⁹ the court weighed the detriment of caring for the promisor against the benefit he had received by living in the property for free.

In *Actionstrength Ltd. v International Glass*²⁸⁰ the House of Lords held that it was important to uphold the purpose of statutory provisions and not to enforce invalid executory agreements. Actionstrength, the subcontractor, had not received payment and was threatening to withdraw their staff. International Glass agreed orally to guarantee the payment of their subcontractor. The subcontractor went into liquidation and Actionstrength turned to International Glass for payment. The House of Lords held that:

²⁷⁴ E.g. in *Dillwyn v Llewelyn* [1862] 45 ER 1285 (QB).

²⁷⁵ E.g. in *Gillett v Holt* [1998] 3 All ER 917 (CD) or *Thorner v Major* [2009] 1 WLR 776 (HL).

²⁷⁶ *Taylor v Dickens* [1998] 1 FLR 806 (CD) .

²⁷⁷ However, note that in *Gillett v Holt* [1998] 3 All ER 917 (CD) it was held that after 40 years the promises were more than a statement of revocable intention.

²⁷⁸ Ibidat 232.

²⁷⁹ *Henry v Henry* [2010] UKPC 3 (PC).

²⁸⁰ *Actionstrength Ltd (t/a Vital Resources) v International Glass Engineering IN.GL.EN SpA* [2003] 2 AC 541 (HL).

*'for in seeking to show inducement or encouragement Actionstrength can rely on nothing beyond the oral agreement of St-Gobain which, in the absence of writing, is rendered unenforceable by section 4. [...]The result would be to render nugatory a provision which, despite its age, Parliament has deliberately chosen to retain.'*²⁸¹

In *Kinane v Mackie-Conteh*²⁸² the defendant had encouraged the claimant to believe that the signed agreement which purported to secure a charge on a house in exchange for a loan was sufficient. The question put before the court was whether this was sufficient to circumvent the requirement of s. 2(1) of the Law of Property Act 1989 ('A contract for the sale or other disposition of an interest in land can only be made in writing and only be incorporating all the terms which the parties have expressly agreed in one document or, where contracts are exchanged, in each'). The purpose of the requirement of formality according to the law Commission was threefold. Firstly it was cautionary, to ensure that the maker realised what he was doing, secondly, it was evidential and thirdly it was meant to ensure that third parties could identify the purpose of the document.²⁸³

The court in *Kinane v Mackie-Conteh*²⁸⁴ found that a combination of constructive trust and estoppel had been established to fall within the exception of s. 2 (5) of the Law of Property Act 1989 and Neuberger L.J.²⁸⁵ stated that S. 2 of the 1989 Act

²⁸¹ Per Lord Bingham of Cornhill.

²⁸² *Kinane v Mackie-Conteh* [2005] EWCA Civ 45 (CA).

²⁸³ Commission, *Working Paper No. 93 - Transfer of Land, Formalities for Deeds and Escrows* (1985), p 4-5.

²⁸⁴ *Kinane v Mackie-Conteh* [2005] EWCA Civ 45 (CA).

²⁸⁵ *Ibid.* at [40].

could not be circumvented just because fairness so demanded. He went on to conclude that *'if it is merely a proprietary estoppel, then section 2 (5) may well not assist Mr Kinane, and his case would run into the same difficulties as that of the party seeking to enforce the guarantee in Actionstrength.'*²⁸⁶

Neuberger L.J. continued to find that *'the essential difference between a proprietary estoppel which does not also give rise to a constructive trust, and one that does, is the element of agreement, or at least expression of common understanding, exchanged between the parties, as to the existence, or intended existence, of a proprietary interest, in the latter type of case.'*²⁸⁷ Neuberger L.J. therefore used the proximity of the doctrine of constructive trust to the doctrine of proprietary estoppel to include the latter in the exceptions of s.2 (5) and Mr Kinane was therefore able to succeed in invoking s. 2(5) of the Act. However, Arden L.J. took a different approach and avoided the assimilation of the doctrine of proprietary estoppel with that of a constructive trust. She found that *'[...] s. 2 (5) plays a role similar to that of part performance, although it operates more flexibly than that doctrine.'*²⁸⁸ In comparison to Neuberger L.J., Arden L.J. found that proprietary estoppel fell within s. 2(5) of the Act. However, the uncertainty created through the abolition of the doctrine of part-performance is not the only hurdle the claimant will have to overcome in succeeding in a claim of proprietary estoppel.

²⁸⁶ Ibid. at [45].

²⁸⁷ Ibid. at [51].

²⁸⁸ Ibid. at [32].

To exemplify the difference, in 1990 the case of *JT Developments*²⁸⁹ came before the Court of Appeal in which Mr and Mrs Quinn owned a coffee shop. The lease came to an end and the landlord served a notice. The Quinns failed to serve the counter-notice but in a telephone conversation the landlord promised that the lease could be extended on the same terms as were also applicable to the landlord's other properties. Mr Quinn then carried out improvements by installing a new kitchen and the court held that the terms were sufficient enough to give rise to proprietary estoppel. In this case the landlord had only led Mr & Mrs Quinn to believe that a new lease would be created, not that a new lease was in place. However, two points must be noted in this case. The first is that the court was not yet faced with the restrictions of s.2 Law of Property Act 1989 and secondly that the terms on which the lease was to be extended were clear.

It would therefore seem that the English courts have moved away from allowing the form requirement to be circumvented in line with the purposes set out by the Law Commission. This comes down on the one hand to certainty but also to the protection of the statute, a value that has been more prominent in the German cases than in the English. In fact at this stage it could be argued that the protection of the statute is merely incidental because it requires the same action to be taken by the courts as inserting certainty into the law. The protection of the statutory provisions reappears in the next section.

²⁸⁹ *JT Developments Ltd v Quinn JT Developments v Quinn* [1991] 62 P & CR 33 (CA).

3.11 Informal Reliance

This case is similar to the form cases in that the parties have not complied with the formal requirements in order to transfer land. However, the difference is here that the party relied on an informal assurance that an interest in the land would arise.

The German Approach

In the '*Farm Inheritance Case*'²⁹⁰ the owner of the farm had promised it to his son if he continued to work on the farm. The son worked on the farm for many years and returned to it on his father's request after completing his army duties. In the last few years before the father's death there had been some disagreement between the son and his parents which led the father to amend his will. Upon his death, the father's will stated that the farm should be transferred to the daughter. The court acknowledged that a fundamental principle was that the father was able to distribute his belongings in the way he saw fit but that in this case the fact that the son had informally relied on his statement and incurred a loss (in this case the fact that the other children went to university, he left the military etc.) meant that this result was contrary to good faith.²⁹¹ The court further held that although the transfer of land usually requires the contract to be in writing in this case there was no need due to the surrounding factors. The principle that the son has incurred a loss through the blameworthy behaviour of the father remains the same (the blameworthy behaviour in this case being the fact that he did not give effect to his promise). The competing values though are slightly different in this case: on the one

²⁹⁰ BGHZ 12, 286 .

²⁹¹ Ibid, at 304.

hand there is the requirement of form in the BGB (see the *Tax Avoidance Case*²⁹² below) on the other hand there is the principle that the father should have the freedom to distribute his assets as he wishes. This final point is in fact similar to that in the *Failed Shopping Centre Case*²⁹³ where the courts were protecting the autonomy of the party to enter (or not enter) into the contract. The reliance of the son on the father's promise though overrides both the final considerations. It could here be argued that that by making the promise to his son the father entered into a quasi-contractual relationship with his son that meant that he had to take into account his interests.²⁹⁴

The English Approach

In 2009 the House of Lords was confronted with the case of *Thorner v Major*²⁹⁵ where the uncle, by his conduct, had represented that an interest in the property would arise. The court took a less strict approach to the requirements of the 1989 Act and thereby followed *Dillwyn v Llewelyn*²⁹⁶ and *Re Basham*.²⁹⁷

A distinction between commercial and domestic claims was made by Lord Walker in *Cobbe*²⁹⁸ where asserted that '*in the commercial context the claimant is typically a business person with access to legal advice and what he or she is expecting to get is*

²⁹² BGH NJW 1996, 1885 (*Tax Avoidance Case*) .

²⁹³ BGHZ 76, 343 (*Failed Shopping Centre Case*) .

²⁹⁴ See § 815 BGB.

²⁹⁵ *Thorner v Major* [2009] 1 WLR 776 (HL).

²⁹⁶ *Dillwyn v Llewelyn* [1862] 45 ER 1285 (QB).

²⁹⁷ *Re Basham* [1986] 1 WLR 1498.

²⁹⁸ *Thorner v Major* [2009] 1 WLR 776 (HL). at [68].

a contract. Mr Cobbe was also a property developer with substantial knowledge of the market, which would support the theory that as long as the parties are aware of the legal position they will not have redress to promissory estoppel.

Nevertheless, it does leave the mystery of the decision in *JT Developments v Quinn*.²⁹⁹ In *Haq v Island Homes*³⁰⁰ Mr Haq had used his solicitor throughout the transaction. Mr & Mrs Quinn did not. They relied on the statements by the landlord which could provide evidence that they did not have sufficient knowledge of the process.

Despite not being the decisive factor, it would seem that the court will take into account the fact of whether the parties were acting within a commercial setting, with access to legal advice or industry specific knowledge. It can therefore be argued that as long as it can be shown that the parties did not have access to legal advice and did not have experience of the market, but relied on the statement of the other party, they may have redress to proprietary estoppel.

Though proprietary estoppel only applies to cases involving property, there is a similar approach to that taken by the German courts. The restriction on the circumvention of the Law of Property Act is an indication that the English courts are supporting a similar value to the German courts, namely the protection of the statutory provisions. However, it also seems that the English courts are restricting the scope of contracts and thereby restricting the form requirements in order to

²⁹⁹ *JT Developments v Quinn* [1991] 62 P & CR 33 (CA).

³⁰⁰ *Haq v Island Homes Housing Association* [2011] EWCA Civ 805 (CA).

give way to the opposing value, namely reasonable reliance. Reasonable reliance in these cases seems to equate to what in Germany has been termed 'trust relationship'. These two values will appear in later chapters so for the moment it will suffice to bear in mind the balance that both jurisdictions are striking between protecting the effect of the statutory provisions³⁰¹ and protecting reasonable reliance (or the trust relationship).

The conclusion that can be drawn from Ch. 3.08 - 3.11 is that the English courts, in protecting the statutory requirements of form, are narrower in their approach. This means that in cases where there is a requirement of form the German courts have been more willing to refuse the party relying on the requirement to do so on the basis that they are protecting the aim of the statutory provisions.

3.12 Tendering cases

Tendering cases have been provided with their own section because they seem to pose quite a distinct problem. In most tendering cases there is quite a significant investment in the preparation of the tender documents and in contrast to simple negotiation cases there is an expectation that the tenders will be considered if they have complied with the formal procedures.³⁰² Tendering cases reappear in Chapter 4 but there the discussion centres on mistakes in the tender documents which is

³⁰¹ Note that later 'protection of the statutory provisions' will have different connotations.

³⁰² See below the cases of *BGH NJW 1993, 520 (Oolitic Stone Case)* for Germany and *Blackpool and Flyde Aero Club v Blackpool BC* [1990] 1 WLR 1195 (CA) for England.

linked to the decisions here in terms of the binding nature of tenders that have been submitted.³⁰³

To set the scene, the central question in the cases is whether entering into the tendering process creates any obligations on the parties or whether the party that has called for tenders is free to either dismiss or not even consider tenders.

The German approach

In the *Oolitic Stones case*³⁰⁴ the plaintiff was invited to submit a tender for the delivery of stones that was limited to 6 tenderers. Three tenderers responded. The first was the plaintiff, who made an offer according to the specifications of DM 237,430.65. The second was Messer who submitted a tender that did not correspond to the type of stone requested in the tender with an expert's report on the suitability of the stones for the project. The final tender was incomplete. The contract was awarded to Messer and the plaintiff argued that the defendant had not complied with the terms and conditions of the tender, and that Messrs should not have been considered. The court agreed and awarded the claimant the positive interest.³⁰⁵ In the more recent *Hospital Sale case*³⁰⁶ the Court of Appeal in Munich (OLG) explained that in tendering cases a trust relationship is created which means that (a) there is an expectation that a party's tender will be considered and (b) that

³⁰³ See Ch. 4.9

³⁰⁴ *BGH NJW 1993, 520 (Oolitic Stone Case)* .

³⁰⁵ The decision was approved in the later case *BGHZ 49, 77* – although it failed on a different point (lapse of time).

³⁰⁶ *BGH MDR 2008, 736 (Hospital Sale Case)* .

the parties will be informed if circumstances of the tender change during the process. Though the BGH reversed the decision of the OLG on the ground that the decision not to use the tenderer had already been made before the circumstances had changed, they confirmed that the tender process can lead to a trust relationship.

In conclusion, the German approach is that if the party is able to show that they would definitely have been awarded the contract had the correct procedures been followed then they will be compensated in line with the positive interest.³⁰⁷ The inference thereby being that they are no longer protecting the reasonable reliance on pre-contractual statements but that they are in fact protecting the expectation that the pre-contractual statement created. It was shown above that one of the reasons that the courts would not hold that a contract exists (or award the positive interest) is that *culpa in contrahendo* is not aimed at creating a duty to contract – *Kontrahierungszwang* – but will protect the reliance. The rationale would be that had the party wanted to sufficiently protect their expectation interest then they should have entered into the contract. This is further supported by the approach in the tender cases on the basis that there is no more the party could have done to ensure that a contract would be formed i.e. they correctly submitted the tender that should have won. The second conclusion is that the pre-contractual duties arise from a trust relationship between the parties.

³⁰⁷ For an explanation of the positive and negative interest see Mehren, *International Encyclopedia of Comparative Law: Remedies for Breach of Contract*, vol 07 (Mohr Siebeck Verlag 1976), p.31.

This conclusion is interesting because it shows that the freedom of contract (here specifically the freedom not to be bound by a contract) is balanced against the trust that is created by entering the tendering process. If the expectations that the invitor creates (which it seems is 'the trust') are not met then the court will find blameworthy behaviour. We see a similar approach in the English cases but based on other values.

The English Approach

The main English case in this area is *Blackpool and Flyde Aero Club Ltd v Blackpool Borough Council*³⁰⁸ where the tenders were supposed to be received by 12 o'clock. The plaintiff placed the tender documents in the letter box at 11 o'clock but the letter box was not cleared by the council staff at 12 o'clock and as a consequence the tender was marked as having been received late. The tender was therefore never considered. Lord Bingham held that the council were in breach of a collateral contract. The contract was to consider the tender application and the defendants were in breach of that contract.³⁰⁹ The result would have been the same in Germany. However, the English courts ensured that this judgment was limited to the facts of this case (mainly on the grounds that there were few tenderers and the fact that the procedure had been made clear by the invitor). Lord Bingham held [...] *where, tenders are solicited from selected parties all of them known to the invitor,*

³⁰⁸ *Blackpool and Flyde Aero Club v Blackpool BC* [1990] 1 WLR 1195 (CA).

³⁰⁹ '[...], counsel for the club was in my view right to contend for no more than a contractual duty to consider. I think it plain that the council's invitation to tender was, to this limited extent, an offer, and the club's submission of a timely and confirming tender an acceptance.' [...].

and where a local authority's invitation prescribes a clear, orderly and familiar procedure [...] the invitee is in my judgment protected at least to this extent: if he submits a conforming tender before the deadline he is entitled, not as a matter of mere expectation but of contractual right, to be sure that his tender will after the deadline be opened and considered in conjunction with all other conforming tenders[...].'

The English approach does not seem to go quite as far as the German in that the German courts were willing to interfere with the decision making process so long as the expectation had arisen on the basis of trust between the parties. The English courts balance the freedom of contract (just as the German courts) against the other party's expectations but not from the trust relationship but from a contractual right.

3.13 Conclusion

This chapter set out by drawing the base-line at unjust enrichment (Ch. 3.04). It is clear that in cases where negotiations are broken off that the party that has benefitted from the breaking off of negotiations in both systems³¹⁰ will at the least have to return the gain. In addition both systems provide additional mechanisms for the parties to recover their losses in cases where the negotiations are broken off due to the fault of the other party. The important conclusion that can be drawn though is that the definition of 'fault' differs in both systems. In Germany the underlying principle is to avoid harm to the other party at the pre-contractual stage.

³¹⁰ Though the German courts have no need to rely on the principle of unjust enrichment due to other devices.

This is based on the fictional trust relationship between the parties which means that in cases where the party changes their mind, changes the terms, convinces the other party that all requirements of form have been completed, or breaks off negotiations for no reason, he will be liable for the negative interest (but which will include economic loss). Fault is therefore the neglect of the interests of the other party.

In the English system, on the other hand, fault must (in the absence of proprietary estoppel cases) be negligent misrepresentation (and here it was shown that the principle can be stretched) or fraud. The courts in tortious cases are particularly reluctant to impose liability for economic loss. The underlying principle in the English cases therefore is that they will not impose liability for fault at the stage of breaking off negotiations. By therefore using the tortious devices liability for pure economic loss is limited. Only in cases where the courts can find a separate contract (and this again goes to the definition of 'fault') will the court provide a remedy in tendering cases. The conclusion therefore is that the difference in the underlying understanding of what fault is leads to the scope of the fault principle in English law being narrower than that in German law.

Chapter 4 – Mistake

4.01 Introduction

This chapter shows a certain continuation of themes from the last chapter. This will apply in two ways: the first is from a doctrinal point of view in that pre-contractual duties are in some cases used by the German courts to fill the gaps in the law of mistake in order to achieve the desired result. The second way in which the themes

are continued is that certain understandings, for example as to the definition of fraud, which differs between Germany and England, reappear.

Similar to the previous chapter there are several underlying values/theories that underpin both jurisdictions and which lead, one way or another, to the same result, for example economic theory, risk allocation, the will theory and certain exceptions (e.g. in cases of joint venture).³¹¹

The aim of the chapter will first be to explain the basis of the German approach, from the approach taken by the Roman law theorists through to Savigny's will theory. The development will show a reliance on the autonomy of the individual as a principle and therefore reliance, in terms of perspective, on the mistaken party, as opposed to the English approach where the reliance is on the objective theory and the objective expression of assent. The different approach to mistakes then ultimately leads (for example through the relationship of § 119 (1) BGB and § 122 (1) BGB where the non-mistaken party was unaware of the mistake) to different results. From those values alone the conclusion can be drawn that the history of mistake has influenced the approach to mistake and thereby injects certain fundamental values, e.g. the party's will, the autonomy of the individual, into the reasoning.

The second aim will be to unravel the reason for the different understanding of fraud and dishonesty in the context of mistake (and also pre-contractual non-disclosure). These values may not necessarily be reflected in the BGB and Ch. 4.8

³¹¹ Though note that these values/theories are in some cases limited by different values.

(using calculation errors as an example) will show the other methods German courts have employed to reach the desired result. The fact that the statutes may not have represented the desired law also proved a willingness to fudge the strict theoretical approaches in order to achieve results which turn out to be similar to the results achieved by the English courts.

The final aim of the chapter will be to highlight a new underlying value which will also reappear in chapter 6, namely the protection of society as a whole. The historic context will provide some indication that certain foundational cases occurred during a time that was particularly receptive to the idea of protecting society as whole. The value itself will be sub-divided into firstly discouraging harmful behaviour (i.e. requiring information to be disclosed which has been acquired in a way that is wrongful – a shared value) and protection of the individual against generally harmful behaviour or unbearable results (and thereby protecting society).³¹²

The conclusion will be that there are several underlying values in the German and English approaches. Some of these values/ theories (e.g. the objective theory of assent, protection against informational imbalance and freedom of/from contract) are similar but are used to a different extent. Other values are much more pronounced in one system and almost non-existent (or at least not expressed) in the other (e.g. protection of society or protection of the BGB).³¹³

³¹² See Ch. 4.6 and Ch. 4.10.

³¹³ Ibid.

4.02 The History of Mistake in Germany

The starting point for the German history of mistake has to be Roman law.³¹⁴ In ancient Roman law only the declaration, rather than the intentions of the parties, counted.³¹⁵ Later, reflected in the writings of Ulpianus, it becomes apparent that for a valid contract there must be consent and that if the parties are not *ad idem* then there is no consent.³¹⁶ The main categories that emerged were the error in corpore (where the purchaser assumes he is buying the Cornelian estate and the buyer is in fact selling the Semporian estate – dissens as to the subject matter of the contract),³¹⁷ error in pretio (where the parties are not *ad idem* as to the price), error in negotio (where the parties did not agree on the nature of the transaction), the error in persona (where the party is mistaken as to whom he is dealing with) and finally the error in substantia (where wine is sold as vinegar or bronze as lead).³¹⁸ The final category is what seemed to provide the Roman lawyers with some difficulty³¹⁹ and, as will be shown later, still provides a similar difficulty today.

³¹⁴ See for example Zweigert and Kötz, *Introduction to Comparative Law* (3rd edn, Oxford University Press 1998), p. 145.

³¹⁵ Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (Clarendon Press 1996); p. 587.

³¹⁶ *Ibid* p. 588.

³¹⁷ There are three scenarios that could be envisaged here but to the Roman lawyers the distinction did not seem to matter); *ibid*; p. 590.

³¹⁸ MacMillan, *Mistakes in Contract Law* (Hart Publishing 2010), p. 18-26.

³¹⁹ Marcellus believed that the mistake was irrelevant but Ulpian disagreed - Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (Clarendon Press 1996); p. 593.

In cases in which the error fell outside the categories the contract remained valid and the parties were left without a remedy.³²⁰ The Roman approach therefore did not really provide a logical theoretical framework for the law of mistake but it does provide a useful categorisation of the different types of mistakes.³²¹

Grotius was the first to attempt to find an underlying theory to the law of mistake.³²² He based the mistake on the 'promissio' – the promise. Grotius was of the opinion that the contract could only be void if its underlying condition turned out not to exist.³²³ Grotius had to acknowledge though that the underlying condition was based solely on the party making the promise and would cause difficulties in relation to the reliability of the promise. He would therefore allow compensation against the party who had caused the mistake or who had not expressed themselves enough as to avoid the mistake, however, still expressing the problem of mistake as one of the fault on the part of the promisor.³²⁴ Pufendorf expanded the theory of Grotius in that he distinguished between the 'Promissum',

³²⁰ Ibid; p. 590.

³²¹ MacMillan, *Mistakes in Contract Law* (Hart Publishing 2010), p.14.

³²² See the account of Diesselhorst, *Die Lehre des Hugo Grotius vom Versprechen* (Boehlaue Verlag 1959), p. 91-105.

³²³ See the account of Haupt, *Die Entwicklung der Lehre vom Irrtum beim Rechtsgeschäft seit der Rezeption* (Verlag Hermann Boehlaus 1941), p. 26-29.

³²⁴ According to Catharine MacMillan Grotius' theory is impossible to apply because the reasons for his theory have been omitted (MacMillan, *Mistakes in Contract Law* (Hart Publishing 2010), p. 35).

the unilateral promise by one party and the 'Pactum', the bilateral promise.³²⁵ It was in relation to the 'Pactum' that Pufendorf (unlike Grotius) differentiated between error in motive and error relating to the object of the promise.

It was Thomasius³²⁶ in 1730 who argued that *dolus* – fault – lies with the promisor if he did not express the conditions underlying the contract or did not with sufficient clarity explain the conditions of the contract. An error in motive, i.e. in the motive for entering into a contract, is irrelevant, whether found to exist before or after the agreement, so long as it had not been made a condition.³²⁷ Thomasius further argued that even a mistake relating to the object of the agreement is only then of importance, i.e. can lead to the contract being void, if it had been specifically made part of the agreement. Thomasius therefore advocated the theory that mistakes were generally irrelevant: '*error in dubio semper nocere debet errant*'. In fact it would seem that Thomasius was incorporating the mistake into the contract by way of a condition which would then lead to a breach of contract (rather than a mistake) and with that approach he did not really move far beyond what Grotius and Pufendorf had already suggested.

³²⁵ See the account of Noda, 'Zur Entstehung de Irrtumslehre Savignys' (1989) 16 *Ius Commune* 81, p. 85.

³²⁶ Thomasius, *Instutiones Jurisprudentialiae Divinae* (Scientia Verlag 1730); see Noda, 'Zur Entstehung de Irrtumslehre Savignys' (1989) 16 *Ius Commune* 81, p. 86.

³²⁷ See the account of Noda, 'Zur Entstehung de Irrtumslehre Savignys' (1989) 16 *Ius Commune* 81, p. 85.

After Thomasius three strands of the theory of mistake developed. Coccejus and later Hufeland, Jacob and Bauer advocated that a contract was generally void if there was no consensus between the parties.³²⁸ It was therefore irrelevant whether the fault for the dissent lay with the party who had erred or whether the error had been created by the non-erring party. An interesting side note is that Bauer, who later came to claim that the mistake would have to be visible to the other party and would have to be proved by the party in error, was one of the teachers to Savigny, who will be discussed shortly, during his student days in Marburg.³²⁹

The second strand was developed by Titius and Heineccius.³³⁰ Only if there was proof of fault by the non-erring party in creating the mistake, would the contract be void for mistake. Gundling, as part of the third strand, advocated that the contract could only be classed as void for mistake if the declaration mistake or mistake as to substance had been fraudulently or negligently caused by the non-mistaken party.³³¹ In cases where only one of the parties was mistaken, the mistake could only be legally relevant if it related to the main purpose of the contract and the

³²⁸ Ibid. p.85.

³²⁹ Ibid. p.85.

³³⁰ See the account of Schermaier, *Die Bestimmung des wesentlichen Irrtums von den Glossatoren bis zum BGB* (Boehlau Verlag 2000), p.267 – 270.

³³¹ See the account of Noda, 'Zur Entstehung de Irrtumslehre Savignys' (1989) 16 *Ius Commune* 81, p. 90 – 91.

mistaken party, according to Gundling, would always have to compensate the other (even without fault), except if the other party knew of the mistake.³³²

In 1756 the Codex Maximilianeus Bavaricus Civilis (CMBC), took a more conservative view. It followed the principle of *error nocet erranti*, the error harms the mistaken person.³³³ It only considered a one-sided mistake as to the content to be legally relevant if the non-mistaken party had caused the mistake fraudulently or negligently and the mistake related to a fundamental element of the contract.³³⁴ If the mistake related to the essence of the contract and was caused by the other party, the contract could be rescinded.³³⁵ Although the code did base the error on a lack of the party's 'will'³³⁶ there is no evidence to suggest that a one-sided error

³³² Gundling, Schwere Lehre, XXI, p.236 in *ibid*, p. 90 – 91.

³³³ According to Schermaier the CMBC follows the approach taken by Thomasius. See Schermaier, *Die Bestimmung des wesentlichen Irrtums von den Glossatoren bis zum BGB* (Boehlau Verlag 2000) , p.351; Cf Wieacker, *Privatrechtsgeschichte der Neuzeit unter besonderer Berücksichtigung der deutschen Entwicklung (Jurisprudenz in Einzeldarstellungen)* (Vandenhoeck und Ruprecht 1996), p. 237.

³³⁴ Codex Maximilianeus Bavaricus Civilis IV, I, § 25: 'Ad 3tium giebt der Irrthum keinen hinlaenglichen Fug zur Annulierung einer Convention, ausgenommen unter folgenden zwey Requisiten: Erstlich muss er sich in einem Haupt-Umstande ereignen, anerwogen blosse Nebendinge, soferne sie nicht aussdruecklich in Bedingniss gebracht sind, diessfalls nichts zur Sache thun. Zweytens muss solcher nicht von einem Dritten, sondern von dem gegenheiligen Compaciscenten selbst Dolo vel Culpa veranlasst seyn, sonst faellt er mehr dem Irrenden, als einem anderen zur Last.

³³⁵ *Ibid* III, 1, § 17.

³³⁶ *Ibid* IV,1, § 25: 'Nichts ist dem Consens und freyen Willen mehr entgegen, als Zwang, Betrug und Irrthum.'

(e.g. an error in declaration) could lead to the contract being rescinded.³³⁷ As a consequence of the approach of referring to the main element of the contract, the mistake as to substance could only be legally relevant if it was an essential characteristic of the main element of the contract and the mistaken party had been misled by the other party, and this is evidenced in the approach taken by the ABGB much later.³³⁸

The Badische Landrecht (BLR) of 1809 took a slightly different approach.³³⁹ It stated that the mistake could be a ground for invalidity of the contract unless the mistaken party had caused the mistake (see below).³⁴⁰ The BLR therefore returned to the principle that the dissent was the focal point of the doctrine of mistake and therefore denied the differentiation between the individual mistake by one party and the bilateral mistake, first proclaimed by Pufendorf (and partially seen in the CMBC above). Hellfeld in 1779 argued that in a bilateral mistake the contract should be void so long as the mistake related to an essential element of the contract (essential negotii), on which the will of the contracting parties was mainly set. In

³³⁷Schermaier, *Die Bestimmung des wesentlichen Irrtums von den Glossatoren bis zum BGB* (Boehlau Verlag 2000), p.351; Cf. Noda, 'Zur Entstehung de Irrtumslehre Savignys' (1989) 16 *Ius Commune* 81, p. 90 ff.

³³⁸ See § 871 ABGB.

³³⁹ Art. 1110 Badisches Allgemeines Landrecht 1809: '*Nur derjenige Irrthum macht den Vertrag nichtig, der das Wesen der Sache oder die Eigenschaft des Vertrags betrifft, hingegen keineswegs derjenige, der nur die Person angeht, mit welcher man uebereinkommen will, es waere dann, dass Ruecksicht auf eine bestimmte Person die Haupt-Ursache der Uebereinkunft waere.*'

³⁴⁰ Art. 1110a *ibid*: '*Auch derjenige Irrthum entkraeftet den Vertrag nicht, der selbstverschuldet ist.*'

contrast in cases where the bilateral mistake did not relate to the essential elements of the contract, despite the mistake being bilateral, the contract would continue to exist. The BLR therefore took a strict approach (similar to the CMBC) to mistake by only allowing the dissensus mistake and there would only be a dissensus mistake if it was not caused by one party for example not inspecting the goods when he could have.³⁴¹

Whilst Gundling had related the unilateral mistake (as to content) to whether the other party had fraudulently or negligently caused the mistake, Hellfeld accepted the principle of fault ('dolus') more widely.³⁴² This meant that where Gundling had not seen any possibility for the mistake in a bilateral error to be relevant, Hellfeld allowed the one-sided mistake, so long as the mistaken party had not brought the mistake upon himself, i.e. he had not self-induced the mistake, and the non-mistaken party knew of the mistake.³⁴³ This shift in thought, namely that the mistaken party must be 'at fault' for their mistake becomes apparent in the following case: if the non-mistaken party had no knowledge of the mistake (and did not induce it) and the mistake was not self-induced, Hellfeld would consider the mistake legally relevant but Gundling would not.

³⁴¹ See Art. 1110a *ibid*.

³⁴² Later developed by Von Jhering, *Jahrbücher für die Dogmatik des heutigen römischen und deutschen Rechts* (4th edn, F. Maucke (accessed via: Digitale Bibliothek des Max-Planck Institut für Europäische Rechtsgeschichte) 1861).

³⁴³ See the account of Noda, 'Zur Entstehung de Irrtumslehre Savignys' (1989) 16 *Ius Commune* 81, p. 103.

The system by Hellfeld was later adopted by scholars such as Bauriedl³⁴⁴ and Weiss³⁴⁵, as well as Glueck, Liekefett and Koechy.³⁴⁶ In 1817 Thibaut, inspired by Roman law, proclaimed that the contract would only be void in cases of a dissent between the parties (*quia consensus deficit*). This meant that Thibaut saw particular difficulties with the one-sided error which the other party was unaware of. Motives by the parties remained irrelevant except in cases in which the motive had been expressly made part of the contractual arrangement or one of the parties wrongly believed that he was required by law to enter into the contract. However, Thibaut was the first to discuss mistakes as to quality in the context of an error in motive and to differentiate between dissensus mistakes and the one-sided mistake.³⁴⁷

The law of mistake therefore has undergone a bit of a rollercoaster ride, with the focus remaining on the dissens of the parties for most of the time. Only with Pufendorf did the idea of the motive surface, which was then combined by Thomasius with the fault aspect. The final approach advocated by Hellfeld seems to mainly rely on the fault element but he also differentiated between the one-sided mistake and dissensus. In all these cases the foundation of the law of mistake

³⁴⁴ Bauriedl, *Theoretisch-praktischer Commentar ueber die Pandecten nach Anleitung des Hellfeldschen Lehrbuchs*, vol 1 (Bayreuth 1789), p. 186-188.

³⁴⁵ A further teacher to Savigny during his time in Marburg.

³⁴⁶ According to Noda, 'Zur Entstehung der Irrtumslehre Savignys' (1989) 16 *Ius Commune* 81, p. 122-125.

³⁴⁷ Though it is not really sure why he did that in light of the fact that he does not allow the one-sided mistake unless it has been caused by the others fault (See *ibid*, p. 108).

seemed to be the 'dissens'. It is Savigny who questioned this approach with a wider approach to the will-theory.

Savigny

Thibaut³⁴⁸ was the starting point for Savigny's approach.³⁴⁹ Savigny differentiated between the mistake relating to the object (or essence) of the contract and the error in motive.³⁵⁰ Generally, Savigny held the error in motive to be irrelevant. He then further divided the mistake relating to the essence of the contract into 'legally relevant' (wesentlich) and 'not legally relevant' (unwesentlich).³⁵¹ Mistakes which he regarded as being legally relevant were cases of a dissent as to the identity of the matter of the contract, mistake as to the quantity which also included the price (here he made further qualifications), mistake as to the existence of the matter of the contract and mistakes as to the identity of the other contractual party.³⁵²

The error in declaration according to Savigny was disturbance of the natural relationship between the will and the declaration. This divergence leads to an incorrect appearance of the will.³⁵³ In consequence, this automatically nullifies the declaration. Savigny then established that the error in declaration was an unreal

³⁴⁸ Ibid, p. 140.

³⁴⁹ Though also note the relationship between Thibaut and Savigny in Ch. 2.1.

³⁵⁰ Savigny, *System des heutigen Roemischen Rechts*, vol 3 (Veit und Comp 1840), p. 242.

³⁵¹ Ibid, p. 336ff.

³⁵² For a brief overview of Savigny's work see Noda, 'Zur Entstehung de Irrtumslehre Savignys' (1989) 16 *Ius Commune* 81, p. 114 -126.

³⁵³ '(...) vielmehr sind sie schon ihrem Wesen nach als verbunden zu denken.' Savigny, *System des heutigen Roemischen Rechts*, vol 3 (Veit und Comp 1840), p.258.

(‘*unechter*’) error, as the error was not the positive reason for the voidability. It was the absence of the will which was the negative reason for the voidability.³⁵⁴

It is from here that Savigny developed the differentiation between error in declaration and error in motive.³⁵⁵ In the case of the error in motive there was no disturbance of the natural relationship between the will and the declaration – they were the same.³⁵⁶ However, the will itself was based on a mistake and for this reason the mistake could not be legally relevant.³⁵⁷ Despite this change in approach Savigny decided to uphold the general approach to mistakes by dividing them into errors in *negotio*, in *persona*, in *corpore* and in *substantia* even though he was aware of the fact that the *error in substantia* was not consistent with his differentiation between the error in declaration and the error in motive.³⁵⁸

After Savigny had already differentiated the error in declaration from the error in motive in relation to the mind-set of the erring party, Zitelmann continued this

³⁵⁴ ‘*Sie ist also stets von einem Irrthum begleitet, aber dieser ist noch der positive Grund des Schutzes, welcher dem Irrenden gegen Nachteil gewahrt wird, sondern dieser Grund ist ganz negative, die blosse Abwesenheit des Willens, wodurch allein dieser Nachteil begründet werden koennte.*’ *ibid* p.263.

³⁵⁵ Noda, ‘Zur Entstehung de Irrtumslehre Savignys’ (1989) 16 *Ius Commune* 81, p. 115.

³⁵⁶ *Ibid.*

³⁵⁷ ‘*Der Irrtum an sich hat in der Regel gar keine Wirkung(...)*’ Savigny, *System des heutigen Roemischen Rechts*, vol 3 (Veit und Comp 1840) p.114.

³⁵⁸ Particularly as the error in *substantia* often did have the conforming will and declaration. See Kramer, *Muenchener Kommentar zum Buergerlichen Gesetzbuch: BGB*, vol 1 (6th edn, C. H. Beck 2012) § 119 Rn 2.

theory and declared the error as to the qualities of the subject matter was equal to the error in motive and therefore not legally relevant.³⁵⁹

Luig argues³⁶⁰ that Savigny's theory of the legally relevant mistake is based on whether the other party was able to recognise the error. However, Noda³⁶¹ points out that in contrast to the ABGB - the Austrian civil code that based their approach on Gundling's analysis - where the error in calculation was only legally relevant if the error could or should have been known by the other party, for Savigny, an error in calculation was always an error in declaration and the contract was to remain valid except that the erroneous amount was to be substituted by the correct amount. Nevertheless, Savigny places much emphasis on the requirement for objective proof by the erring party to show that he really erred. In other words a mere mental reservation was not a legally relevant error because the party would not be able to prove he had erred and only the objective proof would be considered sufficient.³⁶² In contrast to previous writers Savigny did not differentiate between mistakes that had been made by one of the parties or both parties.

With the emergence of Savigny's theory, that the will of the parties was the foundation of a contract, the approach to mistake changed. Zitelmann picked up the fundamental idea of the will theory and the first proposal for the BGB followed

³⁵⁹ Zitelmann, *Irrtum und Rechtsgeschaeft: eine psychologisch-juristische Untersuchung* (Duncker & Humboldt 1879), p. 433.

³⁶⁰ Luig, 'Savignys Irrtumslehre' (1979) VIII *Ius Commune* 36, p. 46.

³⁶¹ Noda, 'Zur Entstehung de Irrtumslehre Savignys' (1989) 16 *Ius Commune* 81, p. 123.

³⁶² *Ibid*, p. 126.

his proposal in that errors as to the quality of the subject matter were classed as not legally relevant (§ 102 first draft of the BGB), just like an error in motive. Error in declaration was also classed as not legally relevant in cases in which the mistaken party was grossly negligent (§ 99 (1) first draft of the BGB). In cases of mere negligence (§ 99(2) first draft of the BGB) liability was based on fault (in accordance with von Jhering's theory³⁶³) with the exception that if the other party knew or should have known of the mistake (§ 99 (3) first draft of the BGB), the error would be classed as legally relevant.

The second proposal of the BGB also followed a less dogmatic approach. Instead of the agreement being invalid in cases of a legally relevant mistake, the party could challenge the agreement.³⁶⁴ It therefore moved away from the contract being considered void, to the contract being considered voidable.³⁶⁵ This move provided the mistaken party, in cases of a legally relevant error, with a choice to either affirm the contract or to rescind the contract.

The drafters of the second proposal were unwilling to find that an error as to motive was never legally relevant and therefore decided that it should be left open for legal science to potentially characterise the error in persona and in *corpore*, and

³⁶³ See Ch. 3.03.

³⁶⁴ Mugdan, *Die Gesammten Materialien zum Bürgerlichen Gesetzbuch für das Deutsche Reich*, vol 3 (R. v. Decker 1899), p. 220-222.

³⁶⁵ Ibid, p. 220-222.

in particular in *qualitate* as errors in mistake.³⁶⁶ They left it open by adding § 119 (2)

BGB which states that

'An error as to those characteristics of a person or thing which are regarded in business as essential is regarded in the same way as an error as to the content of a declaration.'

Von Jhering in his theory on *culpa in contrahendo* identified how a mistake that made the contract void meant that the person least at fault would end up carrying the burden of the mistake.³⁶⁷ The route taken by the BGB is a less direct reliance on the fault principle³⁶⁸ in that it is not the party that made the mistake who needs to be at fault – he is liable under § 119 (1) BGB. The fault element is considered in relation to the non-mistaken party under § 122 BGB. The fault principle is therefore whether the non-mistaken party should have warned the mistaken party and is therefore at fault. The consequence would then be that the mistaken party would not have to compensate the non-mistaken party.

The result is that the BGB imposes a duty on the party rescinding the contract to compensate the other for their losses sustained relying on the validity of the contract. Looking back to Savigny's original ideas, the mistake was purely based on

³⁶⁶ Ibid, p.246.

³⁶⁷ See Chapter 3.03.

³⁶⁸ Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (Clarendon Press 1996), p. 587.

the subjective view of the party making the mistake.³⁶⁹ The first version of the BGB took a very subjective view and was criticised.³⁷⁰ The combination of the criticism and Boerner's idea of the objective causality,³⁷¹ i.e. the objective analysis (rather than the subjective) of whether the other party would have entered into the agreement,³⁷² lead to what is now § 119 BGB. This has meant the integration of the subjective criteria (i.e. was the mistake the reason to conclude the contract) and the objective criteria (i.e. would it have been reasonable for the mistaken party not to enter into the contract) into the law on errors of declaration. The compromise being though that the other must be compensated for their loss in reliance on the declaration (unless they knew or should have known of the mistake § 122 (2) BGB).

This historical analysis has shown that the discussion has generally focused on what the Romans identified as *consensus ad idem*. Originally it seem that only objective mistakes would be considered legally relevant. Even Pufendorf's error in motive relied on the objective identification of the error. Savigny's idea to base the mistake

³⁶⁹ Though there was a need to objectively prove that there was a mistake (see above).

³⁷⁰ See particularly Leonhard, Heinsheimer and Enneccerus, *Gutachten und Vorschlaege zum 20. Deutschen Juristentag*, vol 1 (1981), at 11.2.3.3 and 11.2.4.2.

³⁷¹ Börner, 'Gegenvorschlag zum 20. Deutschen Juristentag' ' in *Gutachten und Vorschläge zum 20 Deutschen Juristentag*, vol 1 (1981), at 11.3.2.2 and 11.4.1.1.

³⁷² Dernburg summarised the principle as: '*Der Irrthum muss naemlich von solchem Gewicht sein, dass man nach Auffassung des Verkehrs und nach der Erfahrung annehmen kann, der Irrende haette das Geschaefft nicht abgeschlossen, wenn er das Sachverhaeltnis gekannt haette*' see Schermaier, *Die Bestimmung des wesentlichen Irrtums von den Glossatoren bis zum BGB* (Boehlau Verlag 2000), FN 396.

on the subjective intention of the party changed the perception of what *consensus ad idem* was – i.e. a subjective dissens. This idea, combined with the element of fault, led then to the balance of §§ 119 and 122 BGB.³⁷³ The next section will show though that the reliance on the will-theory brings with it some fundamental conceptual and practical problems.

4.03 The Will Theory in Practice

Savigny's will theory fits in well with the strong protection of the autonomy of the individual in German law.³⁷⁴ The private autonomy of individuals is expressed by the German phrase of '*Selbstgestaltung durch Selbstbestimmung*' – '*self-design through self-determination*' which leads to the conclusion that should there be any flaw in the process of self-determination, then the declaration loses the main

³⁷³Markesinis, Unberath and Johnston, *The German Law of Contract: A Comparative Treatise* (2nd edn, Hart Publishing 2006), p.265; Staudinger, *Kommentar zum Bürgerlichen Gesetzbuch mit Einführungsgesetz und Nebengesetzen §§ 90 - 124; §§ 130 - 133 (Allgemeiner Teil 3)* (14th edn, Sellier de Gruyter 2014) § 119 RN 2.

³⁷⁴ In fact the German constitution protects the autonomy of the individual: Art. 2 Grundgesetz: '(1) *Jeder hat das Recht auf die freie Entfaltung seiner Persönlichkeit, soweit er nicht die Recht anderer und nicht gegen die verfassungsmäßige Ordnung oder das Sittengesetz verstößt.* (2) *Jeder hat das Recht auf Leben und körperliche Unversehrtheit. Die Freiheit der Person ist unverletzlich. In diese Rechte darf nur auf Grund eines Gesetzes eingegriffen werden.* Translation: (1) *Every personal shall have the right to free development of his personality insofar as he does not violate the rights of others or offend against the constitutional order or the moral law.* (2) *Every person shall have the right to life and physical integrity. Freedom of the person shall be inviolable. These rights may be interfered with only pursuant to a law.*' See also Ch. 2.02 on general norms and their relationship to the German constitution.

reason for the legal effect of the declaration.³⁷⁵ Stepping back for a moment from the idea of mistake, the protection of the will must begin earlier in the contracting process, something that Savigny also discussed.³⁷⁶ So what happens if the party never had the intention of entering a contract at all? The famous '*Trier Wine Auction*'³⁷⁷ example comes to mind, where the buyer attends a wine auction and during the auction waives to a friend. The auctioneer interprets the waiving as the highest bid. On the basis of the will theory there can never have been a declaration since he never 'willed' to make any such declaration. In other words there would be no contract and therefore no reason to compensate the auctioneer under §122 BGB.

The difficulty with the approach in the *Trier Wine Auction*³⁷⁸ case is that objectively there seemed to be a declaration and the other party (just as in von Jhering's examples) may have expended money on the belief that there was a contract. In the *Bank Guarantee Case*³⁷⁹ the bank sent a letter to a firm, confirming that it had guaranteed the debts of one of their customers. The firm then attempted to enforce that guarantee against the bank and the bank had to admit that they had provided an incorrect statement of fact and that they had no subjective intention of

³⁷⁵ Staudinger, *Kommentar zum Bürgerlichen Gesetzbuch mit Einführungsgesetz und Nebengesetzen* §§ 90 - 124; §§ 130 - 133 (*Allgemeiner Teil* 3) (14th edn, Sellier de Gruyter 2014); § 116 RN 3.

³⁷⁶ Savigny, *System des heutigen Roemischen Rechts*, vol 3 (Veit und Comp 1840), p. 258.

³⁷⁷ Beale and others, *Contract Law: Ius Commune Casebooks for Common Law of Europe* (2nd edn, Hart Publishing 2010), p. 453-454.

³⁷⁸ Ibid.

³⁷⁹ BGHZ 91, 324 (*Bank Guarantee*) .

entering into a contract. The court held that even if the party did not intend to consent to enter into the contract he will be held to have expressed his consent if he knew or should have known that the other party would (and in fact did) believe it to be valid consent.³⁸⁰ This fits well with the analysis of von Jhering of fault at the contractual stage. The proof of fault was that they must have (or should have known) that their statement would be received as consent and are therefore bound by the contract. The objection that could be raised here is that the will is not adequately protected. This is when § 119 BGB provides the protection of the parties will in that the moment the other party notices that they have made a mistake they can rescind the contract. If the other party has incurred a loss through the reliance on the statement (back to von Jhering) the mistaken party will have to compensate for the reliance loss through § 122 BGB. The court's argument therefore was that the private autonomy of the individual was sufficiently protected by § 119 BGB because the self-design is not only predicated on the protection of the will of the individual but also on the trust of the other party.³⁸¹ In contrast then to the *Trier*

³⁸⁰ Ibid, at 71: *„Eine Willenserklärung liegt bei fehlendem Erklärungsbewußtsein allerdings nur dann vor, wenn sie als solche dem Erklärenden zugerechnet werden kann. Das setzt voraus, daß dieser bei Anwendung der im Verkehr erforderlichen Sorgfalt hätte erkennen und vermeiden können, daß seine Erklärung oder sein Verhalten vom Empfänger nach Treu und Glauben und mit Rücksicht auf die Verkehrssitte als Willenserklärung aufgefaßt werden durfte [...]“*.

³⁸¹ Ibid, at 70: *„Das Recht der Willenserklärung baut nicht nur auf der Selbstbestimmung des Rechtstraegers auf; es schützt [...] das Vertrauen des Erklärungsempfängers und die Verkehrssicherheit [...]“*.

*Wine Auction case*³⁸² it seems like the courts have moved away from the strict application of the will theory on the basis that the private autonomy is protected through the law of mistake.

The *bank guarantee case*³⁸³ also added a second layer to the law of mistake. They held that the contract could only be rescinded if the erring party brings the error to the attention of the other party without delay. The court therefore concluded that § 119 (1) BGB could not apply in this scenario due to the delay (two weeks) between the party knowing that they were mistaken and informing the other of the mistake. The reason was that according to § 121 (1) BGB the bank had a duty to rescind the contract without undue delay and had failed to comply.

Coming back to the actual mistake cases, where it is clear that the mistaken party meant to make a declaration but did not mean to make that declaration and the other party knew that, the joint will (rather than the declaration) will prevail. In the *Rubel case*³⁸⁴ a loan had been provided in roubles but was to be repaid in marks. An error was made in calculating³⁸⁵ the exchange rate and the wrong amount was entered into the contract. The court held that the parties clearly meant to contract on the basis of the actual rate on that day and it was therefore a case of *falsa*

³⁸² Beale and others, *Contract Law: Ius Commune Casebooks for Common Law of Europe* (2nd edn, Hart Publishing 2010), p. 453-454.

³⁸³ BGHZ 91, 324 (*Bank Guarantee*) .

³⁸⁴ RGZ 105, 406 (*Rubel Case*) a similar case is LG Kleve WM 1991, 2060 (*Dinare case*) .

³⁸⁵ Note Ch. 4.8 on the errors in calculation.

demonstration non nocet.³⁸⁶ This principle is generally used to rectify agreements in which both parties did not express in the contract what they actually meant. In the ‘*Shark Meat*’ case³⁸⁷ for example the buyer and seller thought they were contracting for the sale/purchase of whale meat when they used the word ‘*Haakjoeringskoed*’, the Norwegian word for shark meat. The court held that the parties had really meant to contract for whale meat and amended the document accordingly. This principle of *falsa demonstration non nocet*, though not part of § 119 BGB, serves to demonstrate the supremacy of the will over the declaration of the will.

Preliminary conclusion

Ch. 4.2 showed how the will theory developed and later became entrenched in the BGB. There is therefore the historic and dogmatic reasoning for the existence of the principle as a fundamental part of the German system and therefore a fundamental element of the legal thought (and as such a value). However, the balance between impeaching on the other’s rights (as was shown in Ch. 4.2 as the limit of the individual’s freedom) and protecting the reasonable reliance seems to have been struck through the notion of ‘fault’. The understanding of what fault is seems to have developed out of the principle of *culpa in contrahendo* as developed by von Jhering. It is the reliance of the non-mistaken party on the declaration of the other

³⁸⁶ This does not apply to all cases of error in calculation. Compare for example *RGZ 101, 107 (Silver case)* or *BGHZ 139, 177*.

³⁸⁷ *RGZ 99, 147 (Shark Meat Case)*.

that must be protected when there is no contract or when there has been a mistake.³⁸⁸

The conclusion therefore must be that the protection of each party's will is a fundamental value (expressed through principles such as *falsa demonstratio non nocet*). However, each party's will is not protected equally, as it would seem that the emphasis in the German cases is the protection of the mistaken party's will and the non-mistaken party's will (to contract) is only protected as to the reliance interest. A further value which is expressed through the protection of the will is the autonomy of the individual (expressed through the strong protection from contracts). Ch. 4.4 will look at the specific instances in which § 119 (1) BGB is used and the relationship to § 122 BGB. It will confirm the conclusion that the focus is on the protection of the will and the need for the reliance based compensation of the non-mistaken party as a consequence.

4.04 Mistake as to Terms in German Law

§ 119 (1) BGB encompasses two types of mistake. The first is the mistake in declaration³⁸⁹ and the second as to the content of the declaration.³⁹⁰ In cases where there is an error in declaration the mistaken party knows what they want to say/write but does not actually say/write that. Examples here included cases where

³⁸⁸ Mistake at this stage is only meant to encompass the mistake in declaration and the mistake as to content (not the mistake as to quality or motive).

³⁸⁹ *Wer bei der Abgabe einer Willenserklärung [...] eine Erklärung dieses Inhalts ueberhaupt nicht abgeben wollte[...]*‘.

³⁹⁰ 'Wer bei der Abgabe einer Willenserklärung ueber deren Inhalt im Irrtum war [...]'.

the mistaken party places the decimal point in the wrong place. In this case A would be able to rescind the contract under § 119 (1) BGB but would be liable to B for any reliance damages under § 122 BGB (unless the non-mistaken party knew of the error - § 122 (2) BGB). It was also shown in Ch. 4.3 that in cases where the non-mistaken party knows what the mistaken party meant to say the court may rectify the contract through *falsa demonstratio non nocet*.³⁹¹

In cases where there is an error as to the content the person making the declaration knows what they are saying/ writing and has every intention to say/write it. However, they believe the word to mean something else. An example in this case would be where A states that they would like to sell apples but in fact believes the word apple to mean pear. In this case A would be able to rescind the contract under § 119 (1) BGB but would be liable to B for any reliance damages under § 122 BGB.^{392 393}

In the *toilet paper case*³⁹⁴ the assistant principal of a school ordered 25 gross rolls of toilet paper. The order form contained many detailed provisions and one of these

³⁹¹ Beale and others, *Contract Law: Ius Commune Casebooks for Common Law of Europe* (2nd edn, Hart Publishing 2010), p.452 -456.

³⁹² See for example *LG Hanau NJW 1979, 721 (Toilet Paper Case)* , where the seller did not know that the word 'Gros' had a special meaning.

³⁹³ It should be noted that this does not include cases in which the mistaken party deliberately does not read what he is signing. Exceptions apply where the mistaken party has a rough idea but the document is something entirely different (I believe I am signing a phone contract when in fact it is a sale contract for a car).

³⁹⁴ *LG Hanau NJW 1979, 721 (Toilet Paper Case)* .

stated that 'gros' meant 12 X 12 which meant that she was ordering 3600 rolls of toilet paper. The assistant principal meant to order 25 large = 'gross' rolls, 'gross' being the German word for large. The court held that the defendant was mistaken as to the meaning of their declaration and that therefore the school can avoid the contract. Of course the school would have had to compensate the company for their reliance on the statement under § 122 (1) BGB. However, the court held that the claimant knew or should have known of the mistake. Firstly because of the spelling error with the word 'gros' and secondly because of the surrounding circumstances (i.e. a small school would not need 3600 rolls) and therefore the school was not liable for the reliance loss (§ 122 (2) BGB). The principle of *falsa demonstratio non nocet* cannot be applied to this scenario because it would bind the non-mistaken party to a contract that they had never agreed to. In line with the argument put forward in Ch. 4.3 this would be imposing a will on the party that they did not have and would therefore be limiting the autonomy of the non-mistaken party, contrary to the protection from contracts.

In both circumstances, error in declaration and error as to content, the will of the mistaken party is protected through § 119 (1) BGB. More importantly the mistaken party is protected from a contract that subjectively they did not mean to enter into whether this was known to the other party or not. § 122 (1) BGB softens the blow for the non-mistaken party who relied on the declaration but only to the reliance interest and only if they did not know and ought not to have known of the mistake. In cases like the *Toilet Paper case*³⁹⁵ the interesting factor is that the court held they

³⁹⁵ Ibid.

should have known of the mistake. This in turn creates an obligation on the non-mistaken party to ensure that the mistaken party has not made a mistake. In other words in the *Toilet Paper Case*³⁹⁶ the company should have asked the assistant principal whether she really intended to order 3600 rolls of toilet paper. This is a point that will be picked up later in Ch. 4.10, the error in calculation section but for now it indicates that the German system expects the interests of the mistaken party (to a certain extent) to be taken into account by the non-mistaken party.

4.05 Mistake as to Terms – English Law

The approach to mistakes as to terms in English law hinges on whether the other party knew (or in some cases ought to have known) of the mistake. It would seem that the relevant factors in the decision of the courts are first whether the mistake was known or whether it merely should have been known to the reasonable man. The second point is whether the contract was written or oral. The final point then relates to whether the contract should be rectified or whether the contract should be set aside. The first fundamental difference to the German approach is that consensus between the parties is measured objectively. In *Smith v Hughes*³⁹⁷ Blackburn J held:

If whatever a man's real intention may be, he so conducts himself that a reasonable man would believe that he was assenting to the terms proposed by the other party, and that other party upon that belief enters into the contract with him, the man

³⁹⁶ Ibid.

³⁹⁷ *Smith v Hughes* [1871] 6 LR 597 (QB).

*thus conducting himself would be equally bound as if he had intended to agree to the other party's terms.*³⁹⁸

However, the line is drawn where the other party knew of the mistake as to terms. In *Hartog v Colin Shields*³⁹⁹ the mistaken party mixed up 'per pound' and 'per piece' making the product significantly cheaper. The court held that there was a mistake as to the terms and that the other party had 'snapped up' the offer. The contract was therefore void. It is clear that the English courts are thereby protecting the mistaken party from being taken advantage of by the party that noticed the mistake and attempted to take advantage of it.

In Northern Ireland, in the case of *Ulster Bank v Lambe*,⁴⁰⁰ the plaintiff had sent an offer for €155,000 when in fact they meant to make an offer for £155,000. The court enforced the contract for £155,000 on the basis that the other party knew of the mistake.

Chitty argues⁴⁰¹ that there is an indication that if the other party should have known that the other party was mistaken as to the terms of the contract (at least in cases where the contract was oral or made by an exchange of written

³⁹⁸ Ibid. p. 607.

³⁹⁹ *Hartog v Colin & Shields* [1933] 3 All ER 566 (KB); see also *Chwee Kin Keong and others v Digilandmall.com Pte Ltd* [2005] 1 SLR(R) 502 (CA).

⁴⁰⁰ *Ulster Bank Ltd v Lambe* [2012] NIQB 31 (QB).

⁴⁰¹ *Chitty on Contracts*, vol 1 (30th edn, Sweet & Maxwell 2013) at 5.076.

communications), there will also be relief for the mistaken party.⁴⁰² This would include cases in which there was a reason to suspect that there has been a mistake and the non-mistaken party failed to query this with the mistaken party. In fact the argument is that if B realised that A had made a mistake (and it was clear what A meant) then B should not be allowed to rely on the outward appearance of what A said. B is therefore the one that should have known⁴⁰³ that he was agreeing to whatever A might have meant.⁴⁰⁴ Whether or not this approach is correct⁴⁰⁵ or will be adopted it shows that there is much less of a protection from contracts (part of the argument in the German cases) in the English approach than in the German approach.

The approach may be different in written agreements. In the case of *Ypatia Halcoussi*⁴⁰⁶ the claimant had sent an offer of U.S. \$100,000 in full and final settlement 'of this dispute' including interest and costs. In making this offer they

⁴⁰² Per Mance J. in *OT Africa Line Ltd v Vickers Plc* [1996] CLC 722 (QB); *Centrovincial Estates v Merchant Investors Assurance Co* [1983] Com LR 158 (CA).

⁴⁰³ See also Toulson L.J. in *Daventry DC v Daventry and District Housing Ltd* [2011] EWCA Civ 1153 (CA).

⁴⁰⁴ McLauchlan, 'The 'Drastic' Remedy of Rectification for Unilateral Mistake' (2008) 124 Law Quarterly Review 608. Cf. Davies, 'Rectifying the Course of Rectification' (2012) 75 The Modern Law Review 412.

⁴⁰⁵ See also the argument in *Chitty on Contracts*, vol 1 (30th edn, Sweet & Maxwell 2013) at 5 -128 'it is undesirable to allow A to go behind a document it has signed save in exceptional circumstances amounting to dishonesty, or something close to it, on B's part.'

⁴⁰⁶ *Olympia Sauna Shipping CO SA v Shinwa Kaiun Kaisha Ltd (The Ypatia Halloussi)* [1985] 2 Lloyd's Rep 364 (QB).

had not noticed that there was a further balance of \$74000 outstanding. The court discussed whether the agreement could be rectified and held

*'[...] it must be shown that Mr Halcoussis had actual knowledge of the defendants' mistake at the time the telex agreement was made. This cannot be shown. One can imagine that Mr Halcoussis was amazed at his own good fortune. He may have wondered if the defendants had overlooked this claim. He may even have thought that they had. But he cannot be shown to have had knowledge of their mistake, even if a mistake be assumed, the less so since the telexes represented no departure from anything which had previously been agree or even assumed.'*⁴⁰⁷

The court went on to conclude that *'[...] where rectification is ordered on the ground of unilateral mistake, the effect is to impose on the non-mistaken party an agreement which, at the time of executing the written instrument, he did not intend to make.'*⁴⁰⁸

The court therefore refused to enforce an agreement where the other party may have assumed that there was some sort of mistake but was unaware what that mistake may be. In this case it seems from what the courts were arguing that there was no duty to question whether there had been any sort of mistake. If the other party had actual knowledge of the mistake then the court will rectify the contract.⁴⁰⁹ At this point it seems that the German and English courts agree on the

⁴⁰⁷ Ibid. p. 371.

⁴⁰⁸ Ibid.

⁴⁰⁹ *Agip SpA v Navigazione Alt Italia SpA (The Nai Genova and The Nai Superba)* [1984] 1 Lloyd's Rep 353 (CA).

approach. Anything less than actual knowledge will not suffice for rectification.

However, there seems to be some evidence that English courts will go further in cases where the non-mistaken party either knew that there was a mistake but not what the mistake was or where the non-mistaken party ought to have known of the mistake but only in cases of an oral contracts or contracts made by the exchange of written communications.

However, a further point must be made about the threshold for what is considered the other party 'ought to have known'. In *OT Africa Lines v Vickers plc*⁴¹⁰ the mistake was made between \$155,000 and £155,000. Here the court held that it was reasonable for the other party to assume that they might increase their offer and therefore offer £155,000.

*He [the defendant] thought that it was only when he was on his way home by taxi for Christmas, that he allowed himself the luxury of considering why Vickers might have preferred to offer sterling. I see nothing strange about that, nor anything to require him to take the unusual course of enquiring whether Lovell White Durrant meant what they said. Why Vickers chose to make the offer they did was irrelevant, while the hard business of considering and deciding whether to accept the offer was in progress.*⁴¹¹

The statement, it is argued, provides more insight into the decision of the courts. If the defendant was required to question whether the other party may have made a

⁴¹⁰ *OT Africa Line Ltd v Vickers Plc* [1996] CLC 722 (QB).

⁴¹¹ *Ibid.* at [174].

mistake then this may interfere with the actual business transaction. The point the court seems to be making is that not only is anything less than actual (or wilfully shutting their eyes)⁴¹² knowledge insufficient but it is also a distraction from the business deal.

The conclusion that can be drawn from mistake as to terms is first that there is less of an emphasis on the protection of the autonomy of the individual, i.e. a protection from contracts, in English law than in German law. Hence in cases where the other party ought to have known of the mistake the door is still open for allowing the written contract to be rectified. Further, the threshold in the English cases for when the other party 'ought to have known' seems to be higher this may be due as will be discovered in Ch. 4.6 and Ch. 4.7 to the different understanding of 'fault' when it comes to making the other party aware of their mistake.

4.06 Non-Declaration Mistakes in German Law

§ 119 (1) BGB dealt with the errors as to content and the mistakes in declaration which in the English law are dealt with as mistakes as to terms. There are two more main types of mistakes. The first is mistakes in motive, the example⁴¹³ here is of the father who goes to a wedding shop to buy a wedding dress ignorant of the fact that the wedding has been called off. He is therefore mistaken as to the motive for entering into the contract. The second type of mistake is the mistake as to quality. This was discussed above in relation to the table that the buyer thought was made

⁴¹² Ibid. per Mance J.

⁴¹³ Rothoef, *System der Irrtumslehre als Methodenfrage der Rechtsvergleichung* (Mohr Verlag 1968), p.229 FN7.

of gold or the property that the buyer believes to be bigger than it is. Mistakes as to quality are now covered by § 119 (2) BGB that provides: *an error as to those characteristics of a person or thing which are regarded in business as essential is regarded in the same way as an error as to the content of a declaration.*⁴¹⁴

The drafting commission of the BGB thought it better not to define what 'essential in business' was to mean and thought they should not try to jump ahead of legal science.⁴¹⁵ This approach was later met with significant criticism and has been described as a 'tour of mystery'.⁴¹⁶ The drafters of the BGB thereby proclaimed that an error as to a characteristic was in certain circumstances to be classed as an error in declaration but left open the question of what those circumstances may be.

The use of § 119 (2) BGB also needs to be considered in light of its time. In and around 1911 several cases were decided on what constituted an essential characteristic, for example the borders of the property,⁴¹⁷ the size and location,⁴¹⁸ the development potential (i.e. could they build on the land and whether it could be used commercially)⁴¹⁹ and the rights associated with the property.⁴²⁰ It was also in 1911 that the government decided to introduce the so-called

⁴¹⁴ §119 (2) BGB.

⁴¹⁵ Mugdan, *Die Gesamten Materialien zum Bürgerlichen Gesetzbuch für das Deutsche Reich*, vol 3 (R. v. Decker 1899), p.238.

⁴¹⁶ Raape, 'Sachmaangelhaftung und Irrtum beim Kauf' (1949) 150 AcP, p. 501

⁴¹⁷ *RG Recht* 1912 Nr. 2797 .

⁴¹⁸ *RG Warnrspr.* 1911 Nr. 368 ; *RG Warnrspr.* 1912 Nr. 205 .

⁴¹⁹ *RG Warnrspr.* 1911 Nr. 172 .

⁴²⁰ *RG Recht* 1912 Nr. 1273 .

‘Reichsversicherungsordnung’, which was the social insurance code for the German Reich. This implies that the mode of thinking at that time was very much focused on assistance by the state for the ‘less fortunate’, the idea of society as a whole working towards a common aim. It is difficult to assess in what way this may have influenced the courts in their decisions but the fact that there were several cases that decided that there had been an error as to an essential characteristic does indicate some influence. In the context of § 119 (2) BGB it justified a more paternalistic approach and direct interference with the contractual risk allocation, which laid the foundation for a broad interpretation of an essential characteristic. The courts have taken a number of approaches attempting to provide guidance on § 119 (2) BGB. The first step for the Supreme Court was to approach the ‘essential characteristics’⁴²¹ and it decided that these should not only include natural characteristics (i.e. made out of wood) but also characteristics which could, in the normal course of business, have a general influence on the value of the object (e.g. it is 100 years old). However, the Supreme Court also added a limit (which cannot be found in the wording of the BGB nor in the comments of the drafting commission), namely that upon entering into the contract it was clear to the other party that the characteristics were essential to the other party (i.e. if it was not already objectively essential to the buyer).⁴²²

⁴²¹ RGZ 64, 264 (269); Kramer, *Muenchener Kommentar zum Buergerlichen Gesetzbuch: BGB*, vol 1 (6th edn, C. H. Beck 2012); §119 RN 102.

⁴²² RGZ 64, 264 (269) .

The Supreme Court added a further group of cases that could be solved by § 119 (2) BGB. In the *Indebted Property Case*⁴²³ where the buyer was mistaken as to the value of the property due to miscalculation of the debts associated with the property, the court held that only in cases where the characteristic had a direct influence on the subject matter of the contract was the error to be classed legally relevant. In other words, circumstances which only indirectly influence the mistaken party's perception are not relevant. In the later *Altitude Case*⁴²⁴ the buyer had purchased a piece of land to build a house. It later turned out that the altitude of the piece of land did not agree with the buyer's health. The court held that §119 (2) BGB did not apply as the buyer's mistake did not relate to essential characteristics. The essential characteristics had to '*generally relate to the appreciation of the subject matter of the contract*'⁴²⁵ and would therefore have to be usual within that context. Unusual characteristics would have to be specifically brought to the other party's attention and would therefore be part of the contract.

Kramer criticises the 'direct – indirect' approach taken by the court. He questions the viability of this approach as it is difficult to define any exact boundaries.⁴²⁶ This also explains⁴²⁷ why in most cases the courts have preferred to stretch the principle

⁴²³ RGZ 149, 235 (*Indebted Property*) .

⁴²⁴ BGH DB 1972, 479 (*Altitude Case*) .

⁴²⁵ Ibid. p. 481.

⁴²⁶ Kramer, *Muenchener Kommentar zum Buergerlichen Gesetzbuch: BGB*, vol 1 (6th edn, C. H. Beck 2012); §119 RN 103.

⁴²⁷ Particularly in relation to the errors in calculation discussed above at Ch. 4.09.

of § 119 (1) BGB⁴²⁸ in order to avoid the problems associated with interpreting § 119 (2) BGB.⁴²⁹ This is presumably why the German Supreme Court moved to the ‘usual – unusual’ (to a third party) approach. Effectively the courts thereby interpreted § 119 (2) BGB to mean that the error must relate to an objective characteristic that is regarded as essential in business.⁴³⁰

The courts have confirmed that being able to build on property,⁴³¹ being able to use property for business purposes⁴³² and any special tax implications⁴³³ were to be considered characteristics essential in business. The value of an object, however, is not considered a characteristic under 119 (2).⁴³⁴ If the mistaken valuation of the object was due to a misjudgement of an essential characteristic of the object then the error is classed as legally relevant. For example, if a painting is sold as being painted by Picasso and the buyer later discovers that it was not painted by Picasso and is therefore worth less, the fact that the picture was sold as being painted by

⁴²⁸ A practice which is condoned by Kramer (Kramer, *Muenchener Kommentar zum Buergerlichen Gesetzbuch: BGB*, vol 1 (6th edn, C. H. Beck 2012); §119, RN 103).

⁴²⁹ Flume, *Allgemeiner Teil des BGB II* (4th edn, Springer Verlag 1992); §24 – 2a.

⁴³⁰ Markesinis, Unberath and Johnston, *The German Law of Contract: A Comparative Treatise* (2nd edn, Hart Publishing 2006), p.298.

⁴³¹ BGHZ 34, 32 .

⁴³² RGZ 61, 84 , 86.

⁴³³ Ibid.

⁴³⁴ Kramer, *Muenchener Kommentar zum Buergerlichen Gesetzbuch: BGB*, vol 1 (6th edn, C. H. Beck 2012) § 119 RN129.

Picasso is considered an essential characteristic.⁴³⁵ This is, however, not always the case. If the seller states that he believes that the painting may have been painted by Picasso and it then turns out that it was not painted by Picasso this is not considered an essential characteristic as the buyer would be seen as taking the risk.

The reverse of this problem seems to have caused the German courts some particular difficulties. In cases in which A sells a picture he believes to be worthless to B and it later turns out to be a lot more valuable the courts have considered different approaches. Flume was quite clear on this problem that the additional value should be attributed to the person to whom it belonged when the discovery (of the additional value) was made.⁴³⁶

The court in Munich⁴³⁷ stated in a case in which the seller had no knowledge that the drawings had been made by Lucas Cranach that it was typical in relation to art objects that they were sold for a price one day but then sold the next day for twice the price and that therefore a claim based on § 119 (2) BGB would have to fail.

However, the German Supreme Court decided⁴³⁸ to expand the theory set out in the *Ming-Vase* case,⁴³⁹ where an inexperienced seller had sold two vases from the Ming Dynasty at a very low price and the age was considered an essential

⁴³⁵ E.g. *BGH NJW 1988, 2597* .

⁴³⁶ Fleischer, 'Konkurrenzprobleme um die culpa in contrahendo: fahrlässige Irreführung versus arglistige Täuschung' (2000) 91 AcP, p. 40.

⁴³⁷ *OLG Muenchen, SeuffArch 1910, 181* .

⁴³⁸ *BGH NJW 1988, 2597* .

⁴³⁹ *RGZ 124, 115* .

characteristic, that a mistake by a seller as to the value of the object due to a misjudgement of an essential characteristic could be legally relevant. Similarly, in the *Duveneck- Leibl* case⁴⁴⁰ a drawing was sold that the seller believed to be painted by Duveneck. The buyer later took the painting for restoration and discovered that the painting was by Leibl. This significantly increased the value of the picture. The seller then claimed for the return of the painting on the basis of § 119 (2) BGB that he had made a mistake as to an essential characteristic of the painting. The court agreed that the mistake in the authorship of the picture was a characteristic that would be considered essential in business under § 119 (2) BGB.

However, in the *Mozart Notebooks* case⁴⁴¹ a party mistakenly sold an item they had meant to keep. The plaintiff claimed that she had separated her notebooks into two piles (one for sale and one not for sale) and that somehow some of the notebooks from the 'no-sale' pile had got mixed up with the sale pile. The court held that there was no error as to what was being sold (§ 119 (1) BGB, i.e. the 'sale pile' of notebooks and there was also no error as to characteristics (§ 119 (2) BGB), as the value or age do not constitute a characteristic within the meaning of § 119 (2) BGB, nor was there an error as to the ownership. There was therefore only an error as to the value of the object which was considered irrelevant by the courts. Also, the court refused to find that there was any duty on the buyer to disclose the value of the objects (§ 123 (1) BGB) on the basis that the nature of the flea-market is to

⁴⁴⁰ BGH NJW 1988, 2597 .

⁴⁴¹ AG Coburg NJW 1993, 938 (*Mozart Notebook Case*) .

sometimes sell items under value (i.e. not to make a profit). This final point of when pre-contractual duties arise will be discussed in more detail below.

In those cases in which the court has held that the characteristic of what is being sold leads to a mistake that is legally relevant it would seem as if the other party could have always prevented the situation. For example in the case where the land could not be used for business purposes or where there were additional tax implications, it could always have been solved by the other party making these circumstances clear.⁴⁴² The hypothesis could therefore be here that the German courts are in fact creating a duty on the non-mistaken party to ensure that the other has all the relevant information that may be important for their decision. It is this hypothesis that will be tested by looking first at the relationship between the pre-contractual duties and the law of mistake.

Pre-contractual duties and Mistakes

The initial use by the German courts of *culpa in contrahendo* was to deal with the negligent misrepresentation cases and not in fact mistake cases.⁴⁴³ As was explained earlier, § 123 BGB only deals with cases where there has been deceit, which requires a (subjective) 'wilful' act. In cases where information was evaluated wrongly, for example, § 123 BGB could not be used. In cases where there had been a negligent misstatement, however, the court found a way to get around this stringent requirement of § 123 BGB by creating a general duty to warn the other

⁴⁴² Assuming that they knew of the other's intentions but as the court has already held that the characteristic has to be objectively essential in business this must be assumed.

⁴⁴³ For a more detail introduction to *culpa in contrahendo* see Ch. 3.03

party of their mistake.⁴⁴⁴ A duty of disclosure may arise where the information was requested⁴⁴⁵ or where it is of overwhelming importance to the other party⁴⁴⁶ or where there is a relationship of trust.⁴⁴⁷ The last two categories are particularly interesting. It is not only a duty to ensure that the information provided is correct but also a duty to actually speak out. The duty, so the court, arises from the underlying duty of good faith in the contracting process.⁴⁴⁸ The fact that the other party did not speak out when they should have warned the other party of their mistake is considered fraud under § 123 BGB.

Logically, *culpa in contrahendo* (as was shown in ch 3.03) should lead to liability in damages but it seems clear that in these cases the court is allowing the mistaken party to avoid the contract.⁴⁴⁹ It therefore seems to be filling the gap between § 119 (2) BGB and fraudulent misrepresentation cases.⁴⁵⁰ It is conceivable that in a case where one of the parties has made a mistake as to a non-essential characteristic, they did so because the non-mistaken party neglected their pre-

⁴⁴⁴ A duty of disclosure may arise where the information was requested (*BGHZ 74, 383, 392*) or where it is of overwhelming importance to the other party (*BGH NJW 1980, 2460* or where there is a relationship of trust (*BGH NJW 1992, 300, 302*)).

⁴⁴⁵ *BGH 74, 383, 392*.

⁴⁴⁶ *BGH NJW 1980, 2460*.

⁴⁴⁷ *BGH NJW 1992, 300*.

⁴⁴⁸ *BGH MDR 1979, 730 (Daktari Film Case)*, at 23. Cf *BGH NJW 1971, 1795 (Liquid Chemicals Case)*, 1799.

⁴⁴⁹ E.g. *BGH NJW 1985, 1769*; *BGH NJW 1993, 2107*.

⁴⁵⁰ Beale, *Mistake and non-disclosure of Facts- Models for English Contract Law* (Oxford University Press 2012), p. 57.

contractual duty to inform them of their mistake. On the 1.04.1981⁴⁵¹ a case reached the German Supreme Court where the seller had explained to the buyer that he would sell him an airplane at the same price he bought it for (i.e. at the cost-price). The parties agreed on the details of the sale and inserted a price into the contract that the buyer believed to be the cost-price. The seller, however, had changed his mind and decided to sell the aeroplane for a profit. Only once the plane had been delivered did the buyer notice that the price he had paid corresponded to the retail price rather than the cost price. The court held that this was not a mistake under §119 (2) BGB but that it was a breach of the pre-contractual duties.⁴⁵² The seller should have informed the buyer that he had changed his mind and was going to sell at a higher price. The court thereby shied away from holding that the price was a characteristic considered essential in business under §119 (2) BGB and preferred to solve the problem via the breach of pre-contractual duties.

For example in 1971 a case reached the German Supreme Court where the claimant had ordered a truck for the transportation of chemical liquids.⁴⁵³ The defendant had proclaimed that this type of truck was about to be entered into serial production. The contract stipulated that any claims for faulty material were limited to six months and that all other claims were excluded. After an accident in Italy the

⁴⁵¹ *BGH NJW 1981, 2050* .

⁴⁵² E.g. *BGH MDR 1976, 565* where knowledge of a change in planning by the council had to be disclosed, *BGH NJW 1979, 2243* where the current use of the property needed authorisation from the authorities and that had not been obtained, *OLG Nuernberg MDR 1983, 665* where the seller knew that it would be impossible to get insurance for the horse in future.

⁴⁵³ *BGH NJW 1971, 1795 (Liquid Chemicals Case)* .

claimant discovered that the truck was unable to carry the weight of the full tank and that if it was filled to the maximum weight, i.e. $\frac{3}{4}$ of the tank, the sloshing of the water inside the tank would cause the truck to sway dangerously. As the contract excluded any remedy apart from faults in the material and the truck had been delivered according to the contractual specifications, the court was unable to find that there had been a breach of contract. However, the court found that there had been a breach of good faith as the seller should have informed the buyer of the fact that the truck would not be able to safely transport chemical liquids, particularly as the buyer had mentioned that the main purpose of the truck was to transport liquid chemicals.

A seller therefore has a duty to disclose defects of the product he is selling.⁴⁵⁴ For example,⁴⁵⁵ if a car has had an accident the seller is required to disclose the nature of any previous damage.⁴⁵⁶ However, this excludes minor damage – except if the buyer specifically questions whether there had been any damage.⁴⁵⁷ In cases of severe defects the seller is under a duty to inform the buyer of any suspicion he may have⁴⁵⁸ or of any suspicion he may have of the defect occurring in the future⁴⁵⁹

⁴⁵⁴ Palandt and Henrichs, *Bürgerliches Gesetzbuch* (66th edn, C. H. Beck Verlag 2007); § 123 RN 5b.

⁴⁵⁵ *BGH* 29, 148 .

⁴⁵⁶ This would now fall under § 434 BGB but also consider the discussion below on the conflict between *culpa in contrahendo* and § 434 BGB.

⁴⁵⁷ *BGH* 74, 383, 392 ; see the first category above.

⁴⁵⁸ Palandt and Henrichs, *Bürgerliches Gesetzbuch* (66th edn, C. H. Beck Verlag 2007); § 123 RN 5b

⁴⁵⁹ See *BGH NJW* 1993, 1323 ; Markesinis, Unberath and Johnston, *The German Law of Contract: A Comparative Treatise* (2nd edn, Hart Publishing 2006), p. 307.

– turning a blind eye is therefore not sufficient to escape liability. This extends to cases where one party enters into an agreement in which payment is due in the future, to disclose any financial difficulties.⁴⁶⁰

The *Liquid Chemical Case*⁴⁶¹ showed that the courts considered the purpose for which the item was sold as an essential element of the contract (something that is now covered by § 434 BGB). The court, however, dismissed the notion that there was a particular relationship of trust – the third category of cases.

If the parties have a particularly close connection, such as being family members, then the court is likely to find a pre-contractual duty of disclosure.⁴⁶² This also applies if the parties have been in a long-term and trusting business relationship⁴⁶³ or if there is a long-term contractual relationship.⁴⁶⁴ In the *Daktari Film* case⁴⁶⁵ the courts held that there was a special long-term relationship between the parties. The defendant transferred his rights in TV shows to the plaintiff and was to receive half of the earnings if a licence was granted to other companies. The plaintiff then agreed with the defendant to waive the rights for the participation in the earnings in return for a lump sum of money. The plaintiff knew at this time that they had

⁴⁶⁰ BGH NJW 74, 1505 .

⁴⁶¹ BGH NJW 1971, 1795 (*Liquid Chemicals Case*) .

⁴⁶² Palandt and Henrichs, *Bürgerliches Gesetzbuch* (66th edn, C. H. Beck Verlag 2007); § 123 RN 5c .

⁴⁶³ BGH LM Nr 25 zu § 242 BGB .

⁴⁶⁴ as long as the parties have had a personal relationship. See Palandt and Henrichs, *Bürgerliches Gesetzbuch* (66th edn, C. H. Beck Verlag 2007); § 123 RN 5c.

⁴⁶⁵ BGH MDR 1979, 730 (*Daktari Film Case*) .

been offered a large sum by a large broadcasting company which far exceeded the lump sum they had offered the defendant. The German Supreme Court held that due to the special long-term relationship (described as similar to 'friendship') the plaintiff had a duty to inform the defendant of the upcoming deal due to the fact that they had relied on the plaintiff's market assessment.⁴⁶⁶ The court further concluded that the fact that the parties had worked towards a common aim of marketing the film and that the plaintiff had no knowledge of how the TV station was distributing the film rights⁴⁶⁷ or which offers had already been made, strengthened the argument that there was a duty to disclose the offer.⁴⁶⁸

It is not only the relationship between the parties which may cause a duty to inform to arise. If one of the parties has a special position in the economy, for example bankers, second-hand car dealers⁴⁶⁹ and sellers who display themselves as being a professional in the particular field,⁴⁷⁰ a special duty to inform arises. For example, the seller of water-softening equipment must inform the buyer that the relevant

⁴⁶⁶ Markesinis, Unberath and Johnston, *The German Law of Contract: A Comparative Treatise* (2nd edn, Hart Publishing 2006), p.310.

⁴⁶⁷ Note that Koetz argues that the defendant would have been in a good position to find the truth. Koetz, *European Contract Law*, vol 1 (Oxford Clarendon 1997), p. 201.

⁴⁶⁸ As a side comment it may be important to mention that in the proceedings the claimant had declared that the defendant, during their last meeting, had made it clear that the film was very difficult to market and that there would be almost no profit. This claim could not be substantiated.

⁴⁶⁹ See also § 311 (see particularly Palandt and Henrichs, *Bürgerliches Gesetzbuch* (66th edn, C. H. Beck Verlag 2007); § 311 RN 66).

⁴⁷⁰ *BGH NJW RR 89, 504*.

authorities recommend not to use water-softening equipment in private homes, for health and environmental protection reasons. This applies even if the seller believes that there is no or little risk to health.⁴⁷¹ It seems that the argument put forward by Koetz - that the cases are based on an assessment of which party is in a better position to establish the defect - holds up well.⁴⁷²

The courts have imposed quite extensive obligations to inform in cases of the sale of land,⁴⁷³ for example, where the seller has a suspicion that the house may be damaged due to house longhorns (a particularly damaging beetle),⁴⁷⁴ however, the seller does not have a duty to inform the buyer that the house is likely to be infected by dry rot if the buyer is aware of the presence of the reasons that cause dry rot.⁴⁷⁵ Further duties exist if the land has been used as a storage facility for chemicals,⁴⁷⁶ if it is going to be declared a nature reserve,⁴⁷⁷ or if the land is not sufficiently protected against flooding.⁴⁷⁸ Looking at the broader picture,⁴⁷⁹ the

⁴⁷¹ Ibid.

⁴⁷² Koetz, *European Contract Law*, vol 1 (Oxford Clarendon 1997), p. 199 -203.

⁴⁷³ Note that many of these cases would now be treated by § 434 as a defect.

⁴⁷⁴ *KG NJW RR 89, 972* .

⁴⁷⁵ *BGH NJW RR 03, 772* .

⁴⁷⁶ *BGH NJW 95, 1549* or *LG Stuttgart NJW RR 03, 1315* .

⁴⁷⁷ *BGH NJW RR 99, 280* .

⁴⁷⁸ *BGH NJW RR 90, 847* .

⁴⁷⁹ However, note that Markesinis alludes that the principle is 'utterly vague', Markesinis, Unberath and Johnston, *The German Law of Contract: A Comparative Treatise* (2nd edn, Hart Publishing 2006), p. 307-310.

court seems to impose a general duty of disclosure on the seller of land in cases in which the history may cause significant increase in cost (e.g. the removal of chemicals) or future events which may make the land unusable for the purpose for which the buyer is purchasing the land (e.g. no permission to use the house for living⁴⁸⁰) where the seller knew or had a suspicion. On the other hand, the court will not impose a duty of disclosure where the information merely regards the reputation of the land,⁴⁸¹ or there is no risk of damage (e.g. previous use as a gas plant).⁴⁸² It is not limited to the land though and may include the protection of the other's reputation. In the *Thor Steinar Case*⁴⁸³ the defendant wanted to lease a shop to sell textiles in a famous 'Hundertwasserhaus'. The defendant wanted to sell items of the brand 'Thor Steinar' which had open links to the radical right-wing parties. The court held that not releasing this information in advance was contrary to § 123 (1) BGB.⁴⁸⁴ The defendant should have known that the information was of vital importance to the plaintiff.⁴⁸⁵

⁴⁸⁰ BGH NJW RR 88, 1290 .

⁴⁸¹ BGH NJW RR 92, 334 .

⁴⁸² BGH NJW 94, 253 .

⁴⁸³ BGH NZM 2010, 788 (*Thor Steinar Case*) .

⁴⁸⁴ Although it is reasoned on the basis of fraud the fraud is justified on the basis that they breached their pre-contractual duty to inform deliberately.

⁴⁸⁵ Note though the case *LG Hamm NJW-RR 2000, 1183* where the fact that the property was going to be used as a brothel did not have to be disclosed. (the decision is generally regarded as questionable: Westermann, Grunewald, Maier-Riemer (Editors), *Erman BGB Kommentar*, (2011) (13th Edition) Verlag Dr. Otto Schmidt; § 433 RN 24).

Further examples of the duty to inform apply where a company is sold that has significant debts⁴⁸⁶ (the same applies in cases of the sale of a house in which the tenants have a history of paying rent late⁴⁸⁷). However, if the seller simply does not believe in the success of the buyer's business venture or the business he is selling there is no duty of disclosure.⁴⁸⁸

There is of course the argument that really what the courts are doing is providing, as close as possible an environment of perfect information. According to Hein Koetz these cases can be analysed on the basis of whether the information was freely available (and therefore on the basis of the economic analysis has any value) and if so then the other party should provide the information to allow the other party to make an informed decision.⁴⁸⁹ Here it is argued, in line with the argument of Hein Koetz, that firstly this cannot be explained on the basis of the protection of the will (there is no will at the time, since the person had not thought about it) but more importantly that it is promoting a positive duty of assistance towards the other party. This was particularly prominent in the *Daktari Film* case⁴⁹⁰ or in the *Thor Steinar Case*.⁴⁹¹

⁴⁸⁶ BGH RR 1989, 306, 307 .

⁴⁸⁷ BGH NJW RR 99, 882 .

⁴⁸⁸ BGH NJW 88, 3205 .

⁴⁸⁹ Koetz and Schaefer, *Judex oeconomicus* (Mohr Siebeck 2003), p. 199-203.

⁴⁹⁰ BGH MDR 1979, 730 (*Daktari Film Case*) .

⁴⁹¹ BGH NZM 2010, 788 (*Thor Steinar Case*) .

The above discussion has shown that the courts are going beyond the mere protection of the will and are in fact taking a flexible approach to pre-contractual duties and mistakes as to quality. Upon closer inspection it seems that the surrounding circumstances of the case can lead to an increase in the duty to provide information prior to the contract (or point out a mistake). In the *Daktari case* it was the dependence of the mistaken party on the non-mistaken party, in the *Thor-Steinar case* it was the ignorance of the building owner. It seems then that the subjective state of mind, position and possible detriment has to be taken into account by the other contracting party in determining whether or not they should release information.

It is difficult with the pre-contractual duties to establish what exactly the courts are protecting. Later it will be shown that the German courts go further than the English courts in requiring the duty of disclosure. In contrast to the analysis of Hein Koetz it is not the economic analysis that can explain this approach⁴⁹² and the simple articulation of caveat vendor does not really seem to explain an underlying philosophy. The judgment in the *Daktari Film Case*⁴⁹³ suggests that a line was crossed at which the buyer could and would expect the other party to assist them in

⁴⁹² Koetz requires that two elements must be fulfilled. First the information must be 'productive' in the sense that it is important to the decisions. That, he concedes, was the case here. However, the second requirement that the information must be 'free', Koetz argues, was not fulfilled. He argues that allowed the TV Company approached them, this was achieved because they had spent time and money building a system of customer contacts (see Koetz and Schaefer, *Judex oeconomicus* (Mohr Siebeck 2003) p.178-180).

⁴⁹³ BGH MDR 1979, 730 (*Daktari Film Case*) .

their decisions. It is almost as if the court is acknowledging a different type of business model which is further validated by the *Thor Steinar Case*⁴⁹⁴. It would seem therefore that even in cases where the parties are not particularly close but the nature of the contract would mean that they will have to work together in future the principle applies. Is it therefore that the courts in fact are dividing between one-off contracts where it is efficient to rely on the caveat emptor principle and then contracts where either the parties have developed a trust relationship or will have to develop a trust relationship where it may be more efficient for both parties to ensure that the other has the full information?

Not all the cases can be subsumed under these categories and so cases such as the *Liquid Chemicals Case*⁴⁹⁵ seem to have fallen into the mix when in fact they should have been dealt with under § 434 BGB but could not because they were not included under the old § 459 BGB.

§§ 433 ff. BGB

German law takes a systematic approach to the analysis of a legal problem in the sense that the provision which is to be applied must be in line with the overall norm. Under the umbrella of the general norm there may be general provisions, so called '*Generalklauseln*' and there may be exceptions to the general provisions, the so called *lex specialis*. § 242 BGB for example is classed as '*Generalklausel*', which cover a wide range of situations in contrast to the *lex specialis* which is supposed to provide legislation for specific scenarios. The *lex specialis*, §§ 433 ff. BGB, takes

⁴⁹⁴ BGH NZM 2010, 788 (*Thor Steinar Case*) .

⁴⁹⁵ BGH NJW 1971, 1795 (*Liquid Chemicals Case*) .

precedence over the general provisions but in turn must be interpreted narrowly.⁴⁹⁶

In other words, whilst the special provisions take precedence over the general provisions they are only to apply to a very specific set of facts. For example, the provisions of the German Commercial Code⁴⁹⁷ would take precedence over the general provisions of the BGB. Any gaps that have not been covered in the Commercial Code will be filled by the general provisions of the BGB.

Before the reform of the law of obligations

The law relating to the non-conformity of goods prior to the reform of the law of obligations was covered by (what was then) §§ 459 ff. BGB (and is now covered by §§ 433 ff. BGB). §§ 459 ff. BGB was interpreted according to the objective theory,⁴⁹⁸ which meant that if the object did not conform to what would normally be expected of the object of sale then there was a defect. What was then § 459 BGB would be considered the *lex specialis* and therefore excluded access to *culpa in contrahendo* (the general norm)⁴⁹⁹ unless there was a gap which had not been covered by the *lex specialis*.⁵⁰⁰ There were three difficulties with § 459 BGB which

⁴⁹⁶ Horn, *Einfuehrung in die Rechtswissenschaft und Rechtspilosophie* (4th edn, C. F. Mueller Verlag 2007).

⁴⁹⁷ Handelsgesetzbuch (HGB).

⁴⁹⁸ Bergjan, *Die Auswirkungen der Schuldrechtsreform 2002 auf den Unternehmenskauf* (Duncker & Humblot 2002), p.137.

⁴⁹⁹ BGHZ 60, 319 (*Lake-Side Property Case*) confirmed in , BGHZ 88, 130 at 134 and BGHZ 96, 302 at 311.

⁵⁰⁰ Bergjan, *Die Auswirkungen der Schuldrechtsreform 2002 auf den Unternehmenskauf* (Duncker & Humblot 2002), p.245.

lead the courts to refer back to *culpa in contrahendo*, the short limitation period, the fact that ‘*in the contract*’ was used literally and the remedies available. § 459 (1) BGB stated:⁵⁰¹

‘The seller of a thing warrants to the purchaser that, at the time when the risk passes to the purchaser, it is free from defects which diminish or destroy its value or fitness for its ordinary use or the use presupposed in the contract. An insignificant diminution in value or fitness is not taken into consideration. (2) The seller also warrants that, at the time the risk passes, the thing has the assured qualities.’

The courts were quite clear on cases of mere negligent failure by the seller to inform the buyer of the non-conformity, because any claim arising from *culpa in contrahendo* was barred if it related to a defect within (what was then) §§ 459 ff.

BGB⁵⁰² and there was no gap in the law which could give rise to *culpa in contrahendo*. This was confirmed by the courts⁵⁰³ as well as the commentators.⁵⁰⁴

⁵⁰¹ (1) Der Verkäufer einer Sache haftet dem Käufer dafür, dass sie zu der Zeit, zu welcher die Gefahr auf den Käufer übergeht, nicht mit Fehlern behaftet ist, die den Wert oder die Tauglichkeit zu dem gewöhnlichen oder dem nach dem Vertrag vorausgesetzten Gebrauch aufheben oder mindern. Eine unerhebliche Minderung des Wertes oder der Tauglichkeit kommt nicht in Betracht.

⁵⁰² BGHZ 60, 319 (Lake-Side Property Case) confirming RGZ 135, 339, 346.

⁵⁰³ Staudinger, *Kommentar zum Bürgerlichen Gesetzbuch mit Einführungsgesetz und Nebengesetzen* §§ 90 - 124; §§ 130 - 133 (Allgemeiner Teil 3) (14th edn, Sellier de Gruyter 2014) § 459 RN 19; Westermann (ed), *Erman BGB Kommentar* (13th edn, Verlag Dr. Otto Schmidt 2011); § 276 RN 114.

⁵⁰⁴ Note, however, that not all commentators agreed with this choice – see below for further details.

In essence, the courts were attempting to prevent claimants using *culpa in contrahendo* to undermine the values of the implied terms of the BGB, particularly of (what was then) §§ 460 BGB⁵⁰⁵ (in combination with § 477 BGB⁵⁰⁶, where the limitation period was set to 6 months, or 1 year for land).

The courts would draw a complicated distinction between what was covered by § 459 (1) and (2) BGB. The differentiation was between the '*Beschaffenheit*', the nature of the object, and the '*zusicherungsfaehige Eigenschaft*', an assured characteristic of the object. § 459 (1) BGB will therefore only cover physical/chemical attributes of the item compared to what was promised in the contract. § 459 (2) BGB covered the assured characteristic but only in so far as it is impliedly or expressly covered in the contract.⁵⁰⁷ However, if the circumstance was such that the defect did not fall within the 'assured character' of the object of sale, i.e. did not fall within (what was then) § 459 (1) BGB, *culpa in contrahendo* could be

⁵⁰⁵ *A seller is not responsible for a defect of quality in the thing sold if the purchaser knew of the defect at the time of entering into the contract. If a defect of the kind specified in 459, par 1 had remained unknown to the purchaser in consequence of gross negligence, the seller is responsible, unless he has guaranteed that the thing is free from the defect, only if he had fraudulently concealed it. '*

⁵⁰⁶ *'The claim for cancellation or reduction and the claim for compensation on account of the absence of a promised quality are barred by prescription, unless the seller had fraudulently concealed the defect, in the case of movables in six months after delivery; in the case of land in one year after the transfer. The period of prescription may be extended by contract. [...].'*

⁵⁰⁷ BGHZ 52, 51, at 54 where the court held that the implied assured characteristic of a contract to buy rabbit meat was that it could be sold.

applied. In the Dryer Case⁵⁰⁸ the claimant had wanted to convert his shop to a laundromat. He saw an advert by the defendant and enquired as to the use of the machines. The defendant came to the claimant's store and sold him several washers and a dryer. It transpired that the dryer needed to be connected to an oven of a particular size and that the claimant's oven was too small because the chimney could not extract the smoke. The court held that the size of the oven was not an assured characteristic under § 459 (2) and that therefore the short limitation period of 6 months could not apply. However, the defendant had a pre-contractual duty to warn the claimant of the requirement for the size of the oven.

The differentiation became important for judges to be able to use *culpa in contrahendo* and exclude the provisions of (what was then) §§ 459 ff. BGB. This meant that the courts were forced to draw a rather complicated and confusing line between the two.⁵⁰⁹ It is not the aim to analyse each definition the court provided but it would seem the courts considered anything directly part of the object a characteristic (therefore (what was then) §§ 459 ff. BGB applied) and any other element (e.g. the relationship to the surroundings⁵¹⁰) became an assured characteristic (and (what was then) §§ 459 ff BGB would not apply, allowing the courts to access *culpa in contrahendo*).⁵¹¹

⁵⁰⁸ BGH NJW 1985, 2472 (Dryer Case) at 2473.

⁵⁰⁹ See for example in *ibid.* at 2473.

⁵¹⁰ An example could include being able to build on the property BGHZ 34, 32, at 41.

⁵¹¹ Haeublein, 'Der Beschaffenheitsbegriff und seine Bedeutung fuer das Verhaeltnis der Haftung aus culpa in contrahendo zum Kaefrecht' (2003) Neue Juristische Wochenschrift 388, p. 389.

The second main difficulty with § 459 BGB was that it stated the defect had to *destroy its value or fitness for its ordinary use or the use presupposed in the contract*. The problem here seems to be that in cases where it was for example not possible to build on the land this could not be seen as a ‘defect’ case because it was not in fact in the contract. In the *Ultrasonic Case*⁵¹² where a doctor had bought a device which was free from technical defects. The sellers had advertised that the device was particularly useful for the use in a particular type of healing method. It later transpired that the healing method itself had no effect on patients at all. § 459 (1) BGB did not apply because the machine functioned the way it was supposed to. Also § 459 (2) BGB did not apply because the device did what it was supposed to according to the particular healing method. The court held that the third difficulty was the limited range of remedies for breach of § 459 BGB. According to § 462 BGB ‘[...] the purchaser may demand annulment of the sale (i.e. cancellation), or reduction of the purchase price (i.e. reduction).’ However the claimant may well be seeking damages which breach of § 459 BGB could not deliver. These three reasons seem to have caused the courts to resort to *culpa in contrahendo* and narrowly read § 459 BGB.⁵¹³

Haeublein stated that the main argument for the judiciary’s unclear and difficult differentiation was to be found in the attempt to circumvent, what were

⁵¹² BGHZ 16, 54 (*Ultrasonic Case*) – for a translation of the case see Beale and others, *Contract Law: Ius Commune Casebooks for Common Law of Europe* (2nd edn, Hart Publishing 2010), p. 483-485.

⁵¹³ Though note that the normal remedies of termination or reduction in price will only apply if the court finds that it was an assured characteristic.

considered to be the harsh results⁵¹⁴ of (what was then) § 477 BGB, which could occur in cases in which defects of the product only became apparent much later. As § 477 BGB limited the action to 6 months after delivery, the more complex transactions in which a buyer for example had purchased machinery where the defect did not become apparent until much later, would leave the seller at an unfair advantage.⁵¹⁵

After the reform of the law of obligations

The main question is whether the reform of the law of obligations either provided a clearer divide between *culpa in contrahendo* and (what is now) §§ 433 ff. BGB, in other words whether the legislator has provided a better definition of what a characteristic is, and/or whether the legislator has excluded the applicability of *culpa in contrahendo* or has allowed *culpa in contrahendo* to continue to apply alongside §§ 433 ff. BGB.

§ 434 BGB reads:

‘The thing is free from material defects if upon the passing of the risk, the things had the agreed quality. To the extent that the quality has not been agreed, the thing is free of material defects: 1. If it is suitable for the use intended under the contract, 2. If it is suitable for the customary use and its quality is usual in things of the same kind and the buyer may expect this quality in view of the type of the thing. [...]’

⁵¹⁴ With the limitation period being (in most cases) just 6 months.

⁵¹⁵ See for example the *BGH NJW 1985, 2472 (Dryer Case)* .

Clearly, Parliament was aware of the difficulties particularly as they claimed in the commentaries to the draft legislation that *‘due to the integration of liability for breach of warranties into the general law in relation to the impairment of performance and the general conformity of legal consequences’*⁵¹⁶ (which includes the amendment to the limitation periods) that the difficulty had almost disappeared.⁵¹⁷ The first aspect which confirms that there has been a significant change is that now the limitation period set by (what used to be) § 477 BGB has been replaced by the significantly longer limitation periods set out in § 438 BGB. The consequence is that there is no need for the courts to look to *culpa in contrahendo* to circumvent the short limitation period of § 477 BGB. The second aspect relates to the division between *culpa in contrahendo* and §§ 433 ff. BGB. It would seem that the legislator broadened § 434 BGB. It does not though seem to have put an end to the use of *culpa in contrahendo*. Three schools of thought have developed from here.

The three approaches

The three schools of thought were summarised in the 2009 *‘Asbestos Case’*⁵¹⁸. The first is that §§ 434 ff. BGB and *culpa in contrahendo* exist alongside each other, each

⁵¹⁶ *‘Einbeziehung der Sachmangelhaftung in das allgemeine Leistungsstörungsrecht mit der weitgehenden Uebereinstimmung in den Rechtsfolgen [...]’*

⁵¹⁷ See Bundestages, *Entwurf eines Gesetzes zur Modernisierung des Schuldrechts 14.05.2001 – 14/6040*; p. 210 – 216.

⁵¹⁸ BGHZ 180, 205 (*Asbestos Case*).

having their own use and require an entirely different set of facts.⁵¹⁹ This view has been promulgated by the Muenchener Kommentar,⁵²⁰ Emmerich⁵²¹ and Haeublein⁵²² and reflects the approach taken by the courts in the *Dryer Case*.⁵²³ This follows the court's differentiation between character and assured characteristics, put forward before the reform of the law of obligations. It allows the courts to fall back on *culpa in contrahendo* in cases where §§ 434 ff. BGB would not provide an appropriate (or any) remedy in the court's eyes. Haeublein in particular argues that §§ 434 ff. BGB only exclude *culpa in contrahendo* in relation to the delivery of a faulty item⁵²⁴ but that a duty to disclose may arise independently.⁵²⁵ The argument is that liability for non-disclosure under *culpa in contrahendo* is the breach of a duty which influenced the decision-making process of the buyer and is therefore not necessarily linked to the delivery of a faulty item.

The second view claims that *culpa in contrahendo* has been entirely replaced by the provisions of §§ 434 ff. BGB and that this even applies to cases in which the seller deliberately deceived the buyer. A view that is proposed by commentators such as

⁵¹⁹ Ibid.

⁵²⁰ Emmerich, *Muenchener Kommentar zum Buergerlichen Gesetzbuch: BGB*, vol 2 (6th edn, 2012), § 311 RN 143.

⁵²¹ Emmerich, *Das Recht der Leistungsstorungen* (6th edn, Verlag C. H. Beck 2005); § 7 RN 35

⁵²² Haeublein, 'Der Beschaffenheitsbegriff und seine Bedeutung fuer das Verhaeltnis der Haftung aus culpa in contrahendo zum Kaefrecht' (2003) *Neue Juristische Wochenschrift* 388 *RGZ* 55, 369, 391.

⁵²³ *BGH NJW* 1985, 2472 (*Dryer Case*).

⁵²⁴ Hereby referring to § 433 I (2) BGB.

⁵²⁵ Or equally items which are not fit for purpose (§ 633 (1) and (2) BGB).

Staudinger/ Matuschek-Beckmann⁵²⁶, Medicus⁵²⁷, Roth⁵²⁸ and Palandt/ Weidenkaff⁵²⁹.

The third view is that §§ 434 ff. BGB covers all situations except for cases where the seller has acted deliberately, in which case the argument is that the seller is not worthy of protection in any way and therefore *culpa in contrahendo* cannot apply.

This would then be caught by the fraud provisions under § 123 BGB. This would also include cases where the other party remained silent when they would have had a duty to speak out.⁵³⁰ This position has been put forward by commentators such as Erman/Grunewald⁵³¹, Jauernig/Berger⁵³² and Huber/Faust⁵³³.

⁵²⁶ Staudinger, *J. von Staudingers Kommentar zum Buergerlichen Gesetzbuch: Staudinger BGB - Buch 2: Recht der Schuldverhaeltnisse* (2004), § 437 RN 67.

⁵²⁷ Medicus, *Allgemeiner Teil des BGB* (10th edn, C.F. Mueller 2010), § 311 RN 58.

⁵²⁸ Roth, 'Anmerkung - Arglistige Täuschung bei einem Mangel ' (2006) JZ 1026, 1026-1028.

⁵²⁹ Bassenge and others, *Palandt- Burgerliches Gesetzbuch* (74th edn, C. H. Beck Verlag 2015) § 437 RN 51a and 51b.

⁵³⁰ Westermann, Grunewald and Maier-Riemer (eds), *Erman BGB Kommentar* (Verlag Dr. Otto Schmidt 2014), Vor § 437 RN 29 with reference to § 433 RN 24 which refers to *BGH NJW 1995, 46* and *BGH NJW 1995, 2160* .

⁵³¹ Westermann (ed), *Erman BGB Kommentar* (13th edn, Verlag Dr. Otto Schmidt 2011); Vor § 437 RN 29.

⁵³² Jauernig/Berger, *Kommentar- Buergerliches Gesetzbuch* (14th edn, C. H. Beck Verlag 2011); § 437 RN 34.

⁵³³ Huber and Faust, *Schuldrechtsmodernisierung- Einfuehrung in das neue Recht* (2002) Ch. 14 RN 29.

The court in the *Asbestos* case,⁵³⁴ where a 1980's building was sold and the buyer was not informed by the seller that it contained asbestos, firstly confirmed that the German parliament had not specifically decided whether or not *culpa in contrahendo* was to be included and secondly that the third approach, i.e. that *culpa in contrahendo* was excluded except in cases where the seller had deliberately not informed the buyer, was their favoured approach.

This decision falls in line with the pre-2001 decisions which generally presumed that (what was then) §§ 459 ff. BGB was only to be overridden in cases in which the seller deliberately did not inform the buyer. Within this context there are two factors which must be highlighted. The first relates to the requirement of a deliberate action or non-action by the seller. It has to be remembered that so long as the seller knows of the defect or had a suspicion of it, the presumption is that the non-disclosure was deliberate.⁵³⁵ As it was shown above, this presumption can be quite difficult to rebut, where for example a car dealer sells a car which the previous owner had claimed was free of any accident the court held that the sales person should have at least had a suspicion. It could therefore be presumed that cases where the seller negligently fails to disclose a particular fact (which the courts consider necessary to be disclosed), they could imply that the non-disclosure was deliberate because the seller should have known if they had correctly checked. The courts are thereby continuing to claim that the only way to circumvent §§ 433 ff. BGB is if the seller deliberately did not disclose the facts/defects but then lowering

⁵³⁴ BGHZ 180, 205 (*Asbestos Case*).

⁵³⁵ Palandt and Henrichs, *Bürgerliches Gesetzbuch* (66th edn, C. H. Beck Verlag 2007); § 123 RN 11.

the bar for what would be considered 'deliberate' in order to allow claims for negligent non-disclosure. In this example it would mean that the seller who had negligently not checked whether the car had previously been in an accident would be deemed to have deliberately not disclosed the fact that the car had been in an accident.

This is also not the only way to circumvent the provisions of §§ 434 ff. BGB. Looking back to the difficulties mentioned by Haeublein, which Parliament had argued were now obsolete, an interesting set of cases has appeared.

In the 1973 *Lake-Side Property Case*⁵³⁶ the property was surrounded by a hedge which to an outsider would seem to demarcate the property. However, the property did not reach as far as the water because the last stretch of land had been rented from a third party. This was also clear from the plans which were included in a bundle. The court held that the case fell within (what was then) §§ 459 ff. BGB and therefore excluded any access to *culpa in contrahendo*.

In the 2011 *Wood-Fence Property Case*⁵³⁷ a property surrounded by a wooden fence which also contained 15m² of the neighbour's land, had been sold. The buyer had been under the impression (due to the fence) that all the land was included, even though the plans had correctly represented the property. Here, the court held that whilst §§ 434 ff. BGB barred any access to *culpa in contrahendo* this was not a case about the characteristics of the property itself (the neighbour's land could

⁵³⁶ BGHZ 60, 319 (*Lake-Side Property Case*) .

⁵³⁷ BGH NJW 2012, 846 (*Wood-Fence Property Case*) .

hardly be a characteristic of the property) and therefore §§ 434 ff. BGB did not apply, allowing for a claim for non-disclosure under *culpa in contrahendo*. In other words the courts re-introduced the differentiation between a characteristic and an assured characteristic.

The reason for the court's reluctance to remove the possibility of accessing *culpa in contrahendo* could be seen as lying in the fact that if the buyer has not discovered the defect within 2 years (exceptions apply for land) he would have no claim under §§ 434 ff. BGB.⁵³⁸ If we consider the example of the car sale, where the car has previously had an accident and the seller is aware of this but decides not to inform the buyer, the buyer is unlikely to want to sell their car within the next two years and therefore unlikely to discover the defect. Nevertheless, in claiming that the seller did not inform him correctly of the defect, the buyer could circumvent the provisions and would therefore have at least a further year to make a claim.

However, it is important that *culpa in contrahendo* does not allow for general circumvention of the provisions of §§ 434 ff. BGB the reason is that § 437 BGB first allows the seller the opportunity to correct any defects⁵³⁹ and allowing the buyer to directly claim for the contract to be rescinded under *culpa in contrahendo* would open the flood gates for buyers to get out of unfavourable contracts by relying on minor defects.

⁵³⁸ See § 438 BGB.

⁵³⁹ See § 437 (1) BGB.

The values of §§ 434 ff. BGB

A key point which must be considered with §§ 433 ff. BGB is that it introduces external values into the contract. Previously the argument had been that the analysis by the courts of the contract is based on the will of the parties and that *culpa in contrahendo* though also going further was giving way to that will (or protecting it). However, §§ 433 ff. BGB imposes a supposed will on the parties which in fact could be argued is quite far from allowing the will of the parties to form the basis of the contract (or the expression of the will). §§ 433 ff. BGB it is argued here is therefore the introduction of external values into the contract which the law sees as the foundation of every will (or only in some cases it is the foundation if taking the grey list into account). In other words the legislator has decided that in a world where the parties are of equal bargaining power these would be the terms that they would have agreed on.

4.07 Other cases of mistake in English Law

The approach to mistakes of any other kind than a mistake as to terms is quite clear in the English approach. It is the principle of caveat emptor expressed in *Smith v Hughes*⁵⁴⁰ that remains the foundational principle of mistake in English law. The decision in *Smith v Hughes*⁵⁴¹, where the buyer believed he was buying old oats when in fact he was buying new oats, held that there was no relief for the buyer because he was only mistaken as to the quality of the object which was not a term of the contract. The court therefore held that there had not been a relevant

⁵⁴⁰ *Smith v Hughes* [1871] 6 LR 597 (QB).

⁵⁴¹ *Ibid.*

mistake. Similarly in *Tamplin v James*⁵⁴² the buyer believed that he was purchasing a larger piece of property than he was actually purchasing and the court provided no relief for mistake. It is not clear from the judgment whether this was deemed to be a mistake as to the terms or as to the substance.⁵⁴³

There are three key points that need to be considered though in addition to the principle of mistake. The first is that in cases where German law has resorted to mistake, English law has the possibility of using misrepresentation.⁵⁴⁴ If the seller has in any way made a misrepresentation,⁵⁴⁵ even if he did not know the truth⁵⁴⁶ (and even if he had no reason to know it) and that misrepresentation induced the buyer into the contract, the court will provide relief for the innocent party. If therefore the seller in the wine-vinegar case made a representation that the bottle contained wine, even if he truly believed the bottle to contain wine, the court would provide relief for the buyer.⁵⁴⁷

The second is that where in the sale of goods cases the previous §§ 433 ff BGB failed the 'not fit for purpose cases',⁵⁴⁸ and therefore resorted to mistake, *culpa in contrahendo* or § 242 BGB, the English courts would have the Sale of Goods Act

⁵⁴² *Tamplin v James* [1880] 15 Ch D 215 (CA).

⁵⁴³ A possible reason for this is that it does not seem to matter in terms of the outcome.

⁵⁴⁴ This has already been discussed in the context of pre-contractual duties in ch. 3.03 ff.

⁵⁴⁵ For more detail on the approach in misrepresentation cases see ch. 3.06.

⁵⁴⁶ *Redgrave v Hurd* [1881] 20 Ch D1.

⁵⁴⁷ Note however that the relief would be rescission or on the basis of reliance damages.

⁵⁴⁸ See Ch. 4.6 above.

1979⁵⁴⁹ to fall back on. The only problem there is that the Sale of Goods Act does not cover cases involving land.

The third is the difficulty in relation to mistakes that occur due to the non-disclosure of information and the balance between the autonomy of the individual and the symmetry of information, as for example in the House damaged by longhorns example⁵⁵⁰ above or the *Daktari Film*⁵⁵¹ case above, are symptomatic for the different values that underlie the German and English system. In the English case of the *Harriette N*⁵⁵² the parties had compromised on the amount of demurrage that would have to be paid. The seller was mistaken as to when the ship had completed unloading. The buyers decided not to inform the sellers of their mistake. The court held that the settlement was binding. In the German cases there was a duty on the non-mistaken party to inform the mistaken party of their mistake and the conclusion was that the displacement of the autonomy of the individual was justified in order to equalise the informational imbalance. The English approach was that the parties should have made full enquiries before entering into the contract. The difficulty that seems to arise for the English courts is where to draw the line in terms of informational symmetry. Assuming that the English courts rely on the protection of the markets (and therefore on the certainty

⁵⁴⁹ See for example Sale of Goods Act 1979, s.14.

⁵⁵⁰ See Ch. 4.6 - *KG NJW RR 89, 972* .

⁵⁵¹ *BGH MDR 1979, 730 (Daktari Film Case)* .

⁵⁵² *Statoil ASA v Louis Drefus Energy Services LP (The Harriette N)* [2008] 2 Lloyd's Rep 685.

of the transaction)⁵⁵³ it seems to justify a higher degree of self-reliance on the parties to discover their own mistakes,⁵⁵⁴ whereas in the German cases this onus is put on the other party unless they were not at fault and then the non-mistaken party will be awarded reliance damages under § 122 BGB.

However, there is a category of cases in English law that is based on the relationship of the parties which increases the duty towards the other party on the basis of that relationship. The main category are the contracts made 'Uberrimae Fidei' where one party has access to material facts which he must disclose to the other party. Contracts of insurance,⁵⁵⁵ to subscribe to shares in a company,⁵⁵⁶ family settlements,⁵⁵⁷ contracts for the sale of land,⁵⁵⁸ contracts for suretyship,⁵⁵⁹ partnerships⁵⁶⁰, maritime salvage agreements⁵⁶¹ or where the parties are in a

⁵⁵³ Kronman, 'Paternalism and the Law of Contracts' (1983) 92 Yale Law Journal 763, 774 – 786.

⁵⁵⁴ The line, as was shown in Chapter 3, seems to be drawn in English cases where there has been a positive misrepresentation (e.g. *Redgrave v Hurd* [1881] 20 Ch D1).

⁵⁵⁵ *Chitty on Contracts* (H. G. Beale ed, Sweet & Maxwell, 2013) at 6-161.

⁵⁵⁶ See *Grogan v Grogan* [1816-19] 3 Swans 400 in *Chitty on Contracts* (Beale ed, Sweet & Maxwell, 2013) at 6-163.

⁵⁵⁷ *Chitty on Contracts* (Beale ed, Sweet & Maxwell, 2013) at 6-164.

⁵⁵⁸ *Ibid.* at 6-166.

⁵⁵⁹ Where there is only a limited duty to disclose. *Ibid.* at 6-170.

⁵⁶⁰ *Bell v Lever Bros Ltd* [1932] AC 161, 227; *Chitty on Contracts* (Beale ed, Sweet & Maxwell, 2013), at 6-172.

⁵⁶¹ Waddams, 'Precontractual Duties of Disclosure' in P Cane and J Stapleton (ed), *Essays for Patrick Atiyah* (Clarendon Press Oxford 1991), p. 243.

relationship of trust and confidence,⁵⁶² all involve an increased duty to disclose information. Chitty argues that the result of such a breach would provide the party with the right to rescind the contract rather than damages.⁵⁶³ Acknowledging the fact that insurance contracts are in themselves 'special' contracts with extensive, specific legislation and that family settlements, suretyship and contracts to subscribe to shares in a company, all deal with very specific contracts, this leaves partnership agreements, to which joint venture agreements can also be added.⁵⁶⁴

In *Banwaitt v Deji*⁵⁶⁵ Mr Banwaitt had been induced into a venture to invest in a project to buy property in Cambodia which was supposed to be sold on to a hotel group shortly after purchase on the understanding that planning permission would be granted. In fact, the person who had been elected to buy the property in Cambodia (because non-nationals would not be able to buy property) turned out to be a fraud and was arrested. In addition, other investors had pulled out of the deal. The defendant then continued to represent that all was well and that 20% of the future purchase price had already been paid by the hotel chain when this was far from the truth. The judge held that the claimant had an undoubted right in damages in the tort of deceit. However, the judge went on to claim:

⁵⁶² *Chitty on Contracts* (Beale ed, Sweet & Maxwell, 2013), at 6-173.

⁵⁶³ Even if the other party kept quiet fraudulently – see *ibid.* 6-151.

⁵⁶⁴ *Ross River Ltd v Cambridge City Football Club Ltd* [2007] EWHC 2115 (CD), at [197], where Briggs J held that the duty of disclosure was not limited to partnerships but may be extended to contracts with elements of a joint venture.

⁵⁶⁵ *Banwaitt v Dewji* [2013] EWHC 876 (QB).

*'Mr Cullen submitted that the relationship between Dr Dewji and Mr Banwaitt was such that Dr Dewji owed Mr Banwaitt a duty of disclosure like that owed in a contract uberimae fidei. [...] I accept that a duty of disclosure arose because Dr Dewji [the defendant] was the orchestrator of the venture, was inviting Mr Banwaitt [the claimant] to join and persuading him to do so, and he knew that Mr Banwaitt was totally reliant on him as Mr Banwaitt said at the time on the golf course and in his email of 1 July 2008. This way of putting it is perhaps the belt to the braces of the case in overt misrepresentation. As the history and my consideration of the case in misrepresentation show, the duty of disclosure was broken at every turn.'*⁵⁶⁶

Particularly interesting in the case is the recollection of the facts. The judgment begins *'The parties to this action lived next to each other in Milton Keynes and were friends.'*⁵⁶⁷ The description is reminiscent of the judgment in the *Daktari* case where the court held that *'where such a trust situation, which in this case lead to the duty to inform the claimant, resulted [...] from the long-standing and close, professional relationship and beyond that from the personal and friend-like relationship, which arose from the utilisation of film series in which [...] they pursued the same goal.'*⁵⁶⁸

⁵⁶⁶ Ibid at 72.

⁵⁶⁷ Ibid at 1.

⁵⁶⁸ *'Ein solcher besonderer Vertrauenstatbestand, der hier zur Aufklärungspflicht der Klägerinnen führt, ergibt sich aus den bereits angeführten Feststellungen des Berufungsgerichts, dass die Parteien in langjährigen intensiven Geschäftsbeziehungen und darüber hinaus in persönlich freundschaftlichen Beziehungen gestanden hatten, die Verwertung der Filmserien [...] aufgrund der beiderseitigen Beteiligung am Erlös im gemeinsame Interesse verfolgt hatten[...]. Ob [...] insoweit von einem*

The question must therefore be raised whether the German approach may in fact be closer to the English approach than has generally been assumed.⁵⁶⁹ In fact in the German case it would seem that the factor of whether this may or may not have been a joint venture was addressed. *‘Whether in so far it can be assumed that it was a joint venture or joint venture-like relationship can remain open.’*⁵⁷⁰ It may well be then that if the Daktari Film case had been brought in the English courts a similar result may have been achieved on the basis of a joint venture.

Still there is a difference between the cases. In the English case the duty seems to arise from the contractual nature which then creates the duty. In *Reading v King*⁵⁷¹ Lord Asquith held that *‘Whenever the plaintiff entrusts to the defendant a job to be performed, for instance, the negotiation of a contract on his behalf or for his benefit,[...] there is such a fiduciary duty.’*⁵⁷² It is therefore the contract that gives rise to the fiduciary relationship which in turn gives rise to a duty of disclosure. In

Gesellschafts- oder Gesellschaft ähnlichen Verhältnis ausgegangen werden kann, kann offen bleiben.
BGH MDR 1979, 730 (Daktari Film Case) at 25.

⁵⁶⁹ E.g. Markesinis, Unberath and Johnston, *The German Law of Contract: A Comparative Treatise* (2nd edn, Hart Publishing 2006) p. 310. Beale, *Mistake and non-disclosure of Facts- Models for English Contract Law* (Oxford University Press 2012), p. 21.

⁵⁷⁰ *‘Ob [...] insoweit von einem Gesellschaft oder gesellschaftsähnlichen Verhältnis ausgegangen werden kann, kann offen bleiben’.* *BGH MDR 1979, 730 (Daktari Film Case)* at 25.

⁵⁷¹ *Reading v Attorney General* [1949] 2 KB 232 (CA) at 236.

⁵⁷² Further confirmed in *Ross River Ltd v Cambridge City Football Club Ltd* [2007] EWHC 2115 (CD) at 197, and by Finn, ‘Fiduciary Law in the Modern Commercial World’ in E McKendrick (ed), *Commercial Aspects of Trusts and Fiduciary Obligations* (Clarendon Press Oxford 1992).

Hospital Products Ltd v United States Surgical Corporation,⁵⁷³ Manson J held that ‘The fiduciary relationship, if it is to exist at all, must accommodate itself to the terms of the contract so that it is consistent with, and conforms to, them’. The extent of the duty, it is submitted here, is the proximity of the parties to each other (or in other words the degree of reliance by the other party). In *Banwaitt v Deji*⁵⁷⁴ the friendship between the parties meant that the duty on Dr Deji was higher than it would probably have been had they been dealing at arm’s length. The next point is that Mr Banwaitt and Dr. Deji were both, although intelligent, not well versed in property related matters and Mr Banwaitt in particular had to rely on his relationship with Dr Deji.

In the *Daktari case*⁵⁷⁵ it was not the joint venture⁵⁷⁶ but the mistake as to a characteristic considered essential in business which at first invoked a duty to disclose. The fact that there had been a mistake was clear but whether it invoked a duty to disclose was the central question.⁵⁷⁷ In other words the extent of the duty was then defined by the relationship of the parties. It would seem therefore that

⁵⁷³ *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, at 97.

⁵⁷⁴ *Banwaitt v Dewji* [2013] EWHC 876 (QB).

⁵⁷⁵ BGH MDR 1979, 730 (*Daktari Film Case*) .

⁵⁷⁶ Mainly because the court excluded this in their judgment.

⁵⁷⁷ Based on the fact that the lower court rejected the notion that it created a duty: ‘Die langjährige, intensive Zusammenarbeit [...] könnten nicht dazu führen, dass von zwei notwendigerweise [...] gegensätzliche Interessenvertretenden Verhandlungspartnern jeweils verlangt werde, dem Gegner alle für dessen Kalkulationen und Risikoeinschätzung geeigneten, für ihn selbst aber nachteiligen Gesichtspunkte ungefragt mitzuteilen.’ BGH MDR 1979, 730 (*Daktari Film Case*) at 12.

the German courts are requiring a general duty of honesty based on the expectation of the mistaken party.⁵⁷⁸ By focussing on the mistaken party, the question that the court seems to be posing is whether there was true consent.

Assuming though that if the *Daktari* case appeared before the English courts and the court were to hold that there was a joint venture the question would still have to be answered whether the relationship was sufficiently proximate to give rise to a duty to inform that there were larger profits that could be made. On the basis that here there were two large commercial parties dealing in their area of expertise it is unlikely that an English court would hold that there was a duty to disclose that sort of information. It seems that it may be the economic analysis⁵⁷⁹ and with that the argument of certainty that serve to explain the English position.⁵⁸⁰

On the basis of the above discussion it can be concluded that in the English cases the law gives relief in cases of misrepresentation, in sale of goods cases and in other exceptional circumstances (e.g. joint venture). However, it does not give relief where the mistake falls outside these boundaries (to which we may have to assume *Daktari*⁵⁸¹ still belongs). This indicates very different values on the basis that the

⁵⁷⁸ This is probably why Hein Koetz and Hans-Bernd Schaefer have decided that the *Daktari* case was decided incorrectly. (see Koetz and Schaefer, *Judex oeconomicus* (Mohr Siebeck 2003), p.178-180).

⁵⁷⁹ Kronman, 'Mistake, Disclosure, Informational and the Law of Contracts' in AT Kronman and RA Posner (ed), *The Economics of Contract Law* (Little, Brown & Co 1967); Koetz and Schaefer, *Judex oeconomicus* (Mohr Siebeck 2003) p.161-180.

⁵⁸⁰ Waddams, 'Precontractual Duties of Disclosure' in Stapleton (ed), *Essays for Patrick Atiyah* (Clarendon Press Oxford 1991), p. 252.

⁵⁸¹ BGH MDR 1979, 730 (*Daktari Film Case*) .

German system focusses on the mistaken party whereas the English system focusses on the behaviour of the non-mistaken party.⁵⁸² In English cases where the mistake is purely self-induced the court will not provide any relief where the German court will.⁵⁸³

4.08 Errors in Calculation – German Law

Generally, it is clear that an internal (i.e. not on the face of the document) calculation that the other party did not and could not have known of will not be relevant.⁵⁸⁴ If the document does not provide any evidence that there has been a mistake (because the mistake was made off the face of the document, e.g. when calculating the wages of the workers), then the mistake must be an error in motive.⁵⁸⁵ Errors that then appear on the face of the document (e.g. $2+5+8=10$) are mistakes in declaration under § 119 (1) BGB.⁵⁸⁶ The LG Hannover held that where the seller in a shop makes a mistake by typing in a lower price from the price tag into the till this would also be considered a mistake in declaration.⁵⁸⁷

The BGH has gone so far as to hold that where the recipient of the mistaken offer clearly knew what the mistaken party meant to offer, then they would be held to

⁵⁸² Though it should be remembered that in cases of innocent misrepresentation the English system will also provide a remedy.

⁵⁸³ Though may have to compensate under § 122 BGB.

⁵⁸⁴ E.g. *RGZ 55, 369, 369 ff.* and Pawlowski, 'Die Kalkulationsirrtümer: Fehler zwischen Motiv und Erklärung' (1997) *JZ* 741, at 741.

⁵⁸⁵ *BGHZ 139, 177* and *BGH NJW 2002, 2312*.

⁵⁸⁶ See obiter *RGZ 64, 266, 266 ff.*

⁵⁸⁷ *LG Hannover NJW RR 1986, 156, 156 ff.*

what the party meant and not what they wrote (see the three cases below).⁵⁸⁸ The interesting case relates to where the other party could or possibly should have known of the mistake⁵⁸⁹ and this is where it seems that the courts have taken several approaches. The approach that has been advocated by Flume was that the mistake in calculation should be corrected on the basis of the agreement and the will of the parties. In other words Flume advocates that in cases where the actual will of the parties is clear (e.g. the *Rubel case*⁵⁹⁰), the will of the party should take precedent over the written document. However, it seems that not all the cases in which the courts wanted to provide relief could be covered by Flume's approach and three further approaches appeared: the general duty of good faith, mistake and abuse of law, fraud and the trust relationship.

The calculation as the basis of the agreement – party intention

The idea here goes back to the basics of contract law – the will of the parties. In the *Rubel case*⁵⁹¹ a loan had been provided in roubles but was to be repaid in marks. An error was made in calculating the exchange rate and the wrong amount was entered into the contract. The court held that this was a legally relevant error as both parties had negotiated on the basis of the exchange rate even though the calculation had not been included in the contract. This was merely a matter of *falsa demonstratio non nocet* and the agreement could be rectified on the basis of the

⁵⁸⁸ BGH NJW RR 1996, 1458 .

⁵⁸⁹ This was left open in BGH NJRW RR 1986. 569 .

⁵⁹⁰ RGZ 105, 406 (*Rubel Case*) .

⁵⁹¹ Ibid. a similar case is LG Kleve WM 1991, 2060 (*Dinare case*) .

correct exchange rate. However, in many calculation cases the non-mistaken party may be agreeing to the total price but there has been a mistake that they should have noticed. For example in the *Builder's Bill case*⁵⁹² where a builder had calculated that the price for the materials was to be DM 54,60 and the cost of labour to be DM 19,23. He then charged a total of DM 54,70 instead of DM 73,93. The court held that this was a legally relevant error due to the fact that the calculation was clearly displayed on the face of the document.

If the court were of the opinion that the other party knew of the mistake or shared the misunderstanding, in other words they said DM 54,70 but clearly both meant DM 73, 93, the court could use the principle of *falsa demonstratio non nocet*.⁵⁹³ Here though the courts is dealing with cases where there is an error in declaration and if the other party did not know of the mistake then they will still have to compensate under § 122 BGB. The underlying value would still be that the courts are giving way to the parties' original intention.

A general duty of good faith

One of the problems that the courts have not addressed is the case where A makes it clear on what basis the calculation will be made (i.e. he will be using the minimum wage for a total of 30 man hours but then inserts a much lower amount into the contract). There is a mistake off the face of the document which the other party could have known. A difficulty here is that the other party may well have known (or at least should have known) of the mistake but that essentially the

⁵⁹² *LG Aachen NJW 1982, 1106 (Builder's Bill Case)* .

⁵⁹³ See Ch. 4.04 above.

mistake is one in motive. Where for example the father informs the seller that he is buying the dress for his daughter's wedding it is questionable whether this additional information (in the previous cases the father had not expressed why he was buying it but the other party nevertheless knew) should lead to any relief for the father – it is essentially an error in motive.⁵⁹⁴

In a case from the 1970s⁵⁹⁵ the defendant had been invited to submit a tender to a local council. The council estimated the costs to amount to around DM 80.000. The defendant submitted a tender for DM 63.000. The second lowest tender was for DM 85.000. The defendant claimed that there had been an error in calculation and that according to § 242 BGB the council had a duty to take the other parties' interests into account. For that reason the claimant should have warned the defendant of their mistake. The court agreed that there was a general duty to inform the other when the non-mistake party identified that there was a mistake but that in this case the claimant had neither recognised the difference in price (30% was not a significant enough mismatch) nor had they noticed that there had been an error in calculation.⁵⁹⁶ It would seem then that a duty to warn the other party of their mistake arises from § 242 BGB. However, in another case from 1985⁵⁹⁷ the council had asked for tenders for the building of a bridge. The contractor had forgotten to factor in the costs of the structural analysis (despite the

⁵⁹⁴ Pawlowski, 'Die Kalkulationsirrtümer: Fehler zwischen Motiv und Erklärung' (1997) JZ 741, 742.

⁵⁹⁵ *BGH NJW 1980, 180*.

⁵⁹⁶ *Ibid.*

⁵⁹⁷ *BGH NJRW RR 1986. 569*.

council providing a disclaimer in the call for tenders to the effect that the cost must be included). The court held here that there was no indication that the council knew of the mistake before the contract had been made and that therefore the contractor was bound to the original contract. Both cases indicate that the threshold for a duty to arise under § 242 BGB is very high. It seems it must be obvious to the other party that there was a mistake.

In 1998⁵⁹⁸ a case reached the German Supreme Court which concerned the building of a house by the local authorities. The authorities asked for tenders from carpenters for the interiors of the new building. The offers were to be handed to the local authority (the claimant) no later than 15 April 1993, and the acceptance of the tenders were to be made by 15 May 1993. The claimant had estimated the costs at around DM 350,758.00. The defendant handed in an offer for DM 305,812.60. On 28 April 1993 the defendant wrote to the claimant explaining that they had forgotten to include the price of transportation and construction. They asked for their offer not to be considered.

On 13 May 1993 the local authority explained that they were accepting the offer. The second closest offer had also been withdrawn due to an error in calculation. Even though there was a significant difference in price (the next lowest tender was for 349,014.10 DM and the highest tender was for the sum of DM 476,209.83) the court held that (contrary to the Court of Appeal) an internal error in calculation will always be not legally relevant even in cases in which the other party knew or should

⁵⁹⁸ BGHZ 139, 177 .

have known of the error. The German Supreme court indicated there may be liability under § 242, even though not in this case, in cases where the other party accepted the offer and insists on the contract even though he knows (or should have known) of the error in calculation.

Mistake and the duty of good faith

In the 2002 the *First Class Holiday Case*⁵⁹⁹ reached the OLG Munich. The claimant was an avid online shopper who had found a first-class ticket online for the price of 728.30 Euros return from Germany to Bangkok. He booked the ticket and received a confirmation at 18.00 hours on 14 July 2002. On the same day at 20.07 hours the company sent an email explaining that there had been a mistake and that the price was in fact meant for the Economy Class. They offered the claimant a first-class ticket for 3676.30 Euros. The claimant insisted on his order and in fact booked the same ticket again in the morning of 15 July 2002. The claimant then offered to compromise the claim if they wished. The court addressed the case on two grounds. The first was that because with regard to the second booking the airline had not disputed the booking (as against the claimant at the time), there was no possibility of addressing the second booking via § 119 BGB. The court held that the claim for the second booking could not succeed on the basis that it was a misuse of the law and was contrary to the principle of good faith (§ 242 BGB). The reasoning was that the claimant knew the market and in comparison to the other airlines must have known that there was a mistake. Especially the fact that he booked a second ticket and then wanted to compromise the claim was evidence of his

⁵⁹⁹ OLG Muenchen NJW 03, 367 (*First-Class Holiday Case*) .

knowledge. With regard to the first booking the court held that this was a declaration mistake (§ 119 (1) BGB and that due to the knowledge he would not be able to recover (§ 122 (2) BGB). It would seem therefore that in a case where the other party knows there has been a mistake simply because of the discrepancy between the price and the market value they cannot take advantage of that offer.

Fraud and the trust relationship

This category has already been discussed above (Ch. 4.6) and includes cases such as the *Daktari Film Case*⁶⁰⁰ and the *Thor Steinar Case*.⁶⁰¹ It is conceivable that one of the parties may have made a mistake on the basis that the other party did not disclose vital information (i.e. the mistake was really one of motive) but that therefore there was a duty of disclosure (due to the relationship). This would mean that non-disclosure is a breach of the pre-contractual duty and therefore amounts to fraud under § 123 BGB.

4.09 Errors in Calculation – English Law

It was shown above how German law will provide a remedy not only in cases where the other party knew of the mistake but also in cases where the non-mistaken party should have known that the other party had made a mistake.⁶⁰² The position in English law is not quite as clear.⁶⁰³ The English courts will grant relief in cases in which the offeror has made a mistake on the face of the document and the offeree

⁶⁰⁰ BGH MDR 1979, 730 (*Daktari Film Case*) .

⁶⁰¹ BGH NZM 2010, 788 (*Thor Steinar Case*) .

⁶⁰² This related to the compensation available to the non-mistaken party under § 122 BGB.

⁶⁰³ *Chitty on Contracts* (Beale ed, Sweet & Maxwell, 2013) at 5-076.

knew of the mistake⁶⁰⁴ or possibly should have known of the mistake.⁶⁰⁵ However, in cases where the mistake is not in the document the courts have been unwilling to provide relief. In comparison to German law, the English courts have recourse to misrepresentation even if the non-mistaken party did not know that he was misrepresenting.⁶⁰⁶

The court's approach in cases where there has been no misrepresentation becomes clear when turning to the case of *Tamplin v James*⁶⁰⁷ where a brew house and the surrounding property were for sale at auction. The auction plans showed the property⁶⁰⁸ consisting of two plots of land. One of these plots which had previously belonged to the property had been sold to the railway. The buyer approached the seller after the auction and went on to purchase the property. The buyer never checked the plans because he knew of the property from when he was a child, not knowing that parts of the property had already been sold and he was buying a much smaller portion. The contract referred to the title map, stating the plots that were to be sold and their size.⁶⁰⁹ The court held that '*if a man will not take reasonable care to ascertain what he is buying, he must take the consequences*'.⁶¹⁰

⁶⁰⁴ *Hartog v Colin & Shields* [1933] 3 All ER 566 (KB).

⁶⁰⁵ See above Ch. 4.05.

⁶⁰⁶ Via innocent misrepresentation.

⁶⁰⁷ *Tamplin v James* [1880] 15 Ch D 215 (CA).

⁶⁰⁸ Even though it seems that the map was quite small (see *ibid.* at 221).

⁶⁰⁹ It should be noted that the court conceded that a buyer may be unaware of the difference between twenty and forty perches (*ibid.* at 219).

⁶¹⁰ *Ibid.* per James, L.J. at 220.

The court expressed concern about the floodgates opening once allowing claims where one party is mistaken⁶¹¹ and in doing so focused much of the attention on the hardship to the non-mistaken party who had reasonably relied on the statement.

In *Webster v Cecil*⁶¹² the seller had made a mistake in his calculations (it would seem though that these calculations had not been shown to the buyer) and added up the sum as being £ 1100 rather than £ 2100.⁶¹³ However, the seller had previously rejected to sell the property at a price of £ 2000 and upon discovering the mistake had contacted the buyer immediately. It is safe to say that the buyer knew of the mistake. The court, in a short judgment, refused to order specific performance but that does not inhibit a claim at common law.⁶¹⁴ Lord James (in *Tamplin v James*) in reference to *Webster v Cecil* states that it is '*a case where a person snapped at an offer which he must have perfectly well-known to be made by mistake [...]*'⁶¹⁵. This could therefore lead to the conclusion that in cases in which one of the parties had made a mistake as to the price (i.e. an error in calculation)

⁶¹¹ Ibid. at 221.

⁶¹² *Webster v Cecil* [1861] 30 Beav 62 (CC).

⁶¹³ Ibid at 63.

⁶¹⁴ The continued existence of the equitable jurisdiction to set aside contracts for unilateral mistakes doubtful (see *Chitty on Contracts* (Beale ed, Sweet & Maxwell, 2013) 5.0.79) (see though *Huyton SA v Distribuidora Internacional de Productos Agrícolas SA* [2003] 2 Lloyd's Rep 780 (CA)) the decision in *Great Peace Shipping Ltd v Tsavliris Salvage (International) Ltd* [2002] EWCA Civ 1407 (CA). (See Yeo, 'Great Peace: a distance disturbance (Case Comment)' (2005) 121 Law Quarterly Review, 393).

⁶¹⁵ *Tamplin v James* [1880] 15 Ch D 215 (CA), at 221.

the other party will not be able to rely on the offer for specific performance⁶¹⁶ if they knew that a mistake had been made. The consequence is therefore that specific performance will be refused if it causes hardship amounting to injustice to the defendant although the defendant may still be liable for damages at common law.⁶¹⁷ This does not really change the approach to errors in calculations. In *Smith v Hughes*⁶¹⁸ where the buyer believed to be buying old oats when in fact he was buying new oats, the court held that there was no relief for the buyer because he was only mistaken as to the quality of the object which was not a term of the contract. It was therefore irrelevant whether the seller knew of the buyer's mistake.

The approach taken in *Smith v Hughes*⁶¹⁹ has been confirmed, in the calculation error context, in a more recent case of *The Harriette N.*⁶²⁰ The case concerned a contract of demurrage in which the seller had miscalculated the amount to be charged to the seller due to the fact that they had entered the wrong dates into the computer system. The buyers admitted that they were aware of the mistake⁶²¹ and did not inform the seller of the mistake. Whilst the court accepted that if there was a mistake as to the terms of the contract and the other party knew of the mistake,

⁶¹⁶ Or the courts may be unwilling to specifically enforce the contract.

⁶¹⁷ *Chitty on Contracts* (Beale ed, Sweet & Maxwell, 2013) at 5.077 – 5.078.

⁶¹⁸ *Smith v Hughes* [1871] 6 LR 597 (QB).

⁶¹⁹ *Ibid.*

⁶²⁰ *Statoil ASA v Louis Drefus Energy Services LP (The Harriette N)* [2008] 2 Lloyd's Rep 685.

⁶²¹ *Ibid.* at 85.

the contract would be considered void, they also held that the seller's date for completion (which was in fact wrong) did not form part of the agreement.⁶²²

In other words, had the calculation been part of the contract (in which case the mistake would have appeared on the face of the document and the other party would or should have known of it), then the contract can probably be avoided under English law. However, if the seller makes a mistake which is not on the face of the document the contract will remain valid, even if the other party knew of the mistake.

This is in stark contrast to the German cases in which relief will be provided for errors in calculation. Relief will be provided in all circumstances if the error was on the face of the document and there is no requirement under § 119 BGB that the other party knew or should have known of the error. In cases where the mistake was made off the document the court will look to whether the other party knew or should have known. If the party knew or should have known then the court will impose a duty of disclosure on the party to bring the error to the attention of the mistaken party.⁶²³ It was shown above that the German courts are protecting the mistaken party in cases when the non-mistaken party should have noticed that there has been an error. The German courts are then willing to impose a duty on the non-mistaken party to confirm that no mistake has occurred.⁶²⁴

⁶²² Ibid. at 87 – 96.

⁶²³ See for example the above at Ch. 4.6.

⁶²⁴ Ibid.

The question remaining is why the English courts have not followed the continental approach in cases in which the other party knew or should have known and the mistake was not on the face of the document. The court seems to provide some indications in the *Harriette N*, where it was held that '*the mistake was entirely the result of carelessness by Mr Rostrup[...]*'.⁶²⁵ It would therefore seem that rather than just protecting the reliance of the other party, which is unlikely in cases in which the non-mistaken party knew of the mistake, there also seems to be an element of punishment of the party making the mistake. At first glance the English approach may seem questionable when just taking into account the contracts between two parties but in cases in which there is a chain of contracts and where contracts have to be made with little time to spare (and therefore often opting for the cheapest option), it may be in the interest of commercial certainty not to require the non-mistaken party to have to enquire as to whether there may have been a mistake.

4.10 Conclusion

This chapter has shown that the theoretical development of mistake has influenced the German approach to mistake which in turn has influenced the perspective from which the courts analyse the cases. In other words the focus in the German cases is on the mistaken party but in the English cases, where there has been a mistake as to terms, the focus is on the non-mistaken party. The will theory in the narrow sense is then limited by reasonable reliance and this approach is reflected in both systems (in Germany through § 122 BGB and in England via the objective theory).

⁶²⁵ *Statoil ASA v Louis Drefus Energy Services LP (The Harriette N)* [2008] 2 Lloyd's Rep 685, at 106.

The autonomy of the individual not to have to enter into an agreement where he was mistaken as to the terms of the contract and the other party knew of the mistake is therefore a shared value. However, the fact that the courts in cases where § 119 BGB did not apply decided to fall back on the principle of *culpa in contrahendo* reveals, similar to the conclusion in chapter 3, that the understanding of the will theory has been expanded to a duty to look after the interests of the other and not doing so will lead to fraud. Not disclosing the mistake to the other party in the English cases is not seen as ‘fault’ in the German sense, except in cases where there is a special relationship (see Ch. 4.9).

A similar value was revealed in Ch. 4.6 and Ch. 4.7 where the courts seem to be protecting the parties against informational imbalance. However, it is quite clear that many of the calculation mistake cases cannot be explained on the principle alone (e.g. see the evaluation of Hein Koetz⁶²⁶ in relation to the *Daktari Film Case*⁶²⁷) and it is the German courts that were willing to use general norms (such as good faith) to achieve their perceived just result. Partly this was explained on the basis of gaps in the legislative provisions (see a.6 on § 434 BGB).

It is not part of this thesis to answer the question whether this second form of background relationship contract exists but the fact that cases along those lines exist provides a basis for expanding the thesis of Chapter 3 where it was disclosed that there seems to be a different understanding of ‘fraud’ in the German and English system. The above was clear that the protection of the parties’ will is

⁶²⁶ Koetz and Schaefer, *Judex oeconomicus* (Mohr Siebeck 2003).

⁶²⁷ BGH MDR 1979, 730 (*Daktari Film Case*)

paramount to a valid contract but that the reliance of the other, as part of the 'Interessenjurisprudenz',⁶²⁸ will be protected through § 122 BGB. In addition though, there seems to be a social element namely that where the result would be unbearable or where there is a relationship of trust exists the courts will step in to ensure protection. The term social is of course rather broad and could firstly be seen in light of the individual parties, i.e. the need to help another clearly in need (see the argument alluded to in Chapter 2 of the *unterlassene Hilfeleistung* which creates a positive duty)⁶²⁹ but secondly it could also be seen in light of the wider social aspect. In the first sense the meaning of social is directed at the individual and that assisting the individual is desirable as a society.

The second sense of social is the fact that society as a whole should be protected from contracts that create unbearable results or through the misuse of trust relationships. The last point is probably best explained in light of the 'Rechtsmissbrauch' cases, where the court holds that enforcing the legal right would be contrary to good faith and therefore a misuse of the law. It would seem that overall it is the protection of society against the misuse of rights in cases that lead to unbearable results⁶³⁰ which is the primary concern. The last point of protection of society as a whole may not seem to fit comfortably at this point but

⁶²⁸ See Heck, 'Gesetzesauslegung und Interessenjurisprudenz' (1914) 112 *Archiv fuer die civilistische Praxis*, p. 1 ff; 'Interessenjurisprudenz' means that the judge is required to fill gaps in the law with reference to the way in which previous cases gave way to the conflicting interests.

⁶²⁹ The influence of which was discussed in Ch. 2.02 as originating in the German constitution.

⁶³⁰ What exactly 'unbearable' means will be discussed in chapter 6.03 in light of society as a whole.

Chapter 6 will reemphasise the validity of the argument in light of unfair standard terms. This social aspect is not entirely lost on the English courts and the chapter has shown that in certain defined circumstances, e.g. joint ventures, the court will apply a similar principle of fault/fraud to the German courts.

Chapter 5- Unfair Contract Terms

5.01 Introduction

The need to create a more efficient and quicker way to contract, as well as being able to apportion risk in advance, has meant that standard form contracts have been increasing in usage since the industrial revolution and have now become the norm. However, with the use of standard form contracts it has also become easier for the economically more powerful party to impose one-sided and unfair terms on the other party. Both the German and the English legal systems have developed mechanisms to protect the disadvantaged party against the use of unfair terms.

The first part of this chapter will provide a historic overview of the development of the principles used by the courts in order to determine whether a term should be considered unfair. The first part of the historic overview will identify two main concerns that influenced the German judges but which are almost non-existent in England. The first is the supposed threat to the principles set out in the BGB through the creation of industry-led, one-sided norms, while the second is the fear of a monopoly or monopolistic (unfair) behaviour. The second part of the historic overview will show how the protection of society as a whole from generally unfair terms becomes the underlying value influencing most of the German courts' judgments.

Ch. 5.3 will begin with a short introduction to the main developments relating to unfair terms in the English courts. The historic overview will show firstly that there is no evidence to suggest that the two underlying values mentioned in the first part of the German overview influenced the English judges. It will show how instead asymmetry of information, and in some cases the protection of the individual's will, have strongly influenced the judges' decisions. The later developments will then show how the individual's knowledge and the application of the term to the individual case are the main underlying values in English Law.

5.02 German Law prior to 1933

The Romans seemed to adhere to a set of standard terms which were available to most merchants.⁶³¹ This is probably the earliest use of a type of standard form contract but differed from what we know today as standard form contracts in that it was a summary of the rules relating to the relevant trade. In other words it was a summary of the existing laws, including case studies, to establish parties' liability more quickly than by using the courts.⁶³² Similarly, in the 15th century, in the upper Italian provinces, notaries would develop generic forms for a particular industry that would often become an industry norm as they were nothing more than a summary of what was common practice (rather than a rule of law) within the

⁶³¹ Hellwege, *Allgemeine Gerschaefstbedingungen, einseitig gestellte Vertragsbedingungen und die Allgemeine Rechtslehre* (Mohr Siebeck 2010), p. 1-5.

⁶³² Raiser, *Das Recht der Allgemeinen Geschaefstbedingungen* (Hanseatische Verlagsanstalt 1935), p. 24-26.

industry.⁶³³ This practice was developed in Germany in the 18th century in a way that is more similar to the general terms and conditions used today.⁶³⁴ The rise of the stock exchange from a rather static to a frequent 'exchange' of shares meant that there was a need for a standardisation of the terms on which these large numbers of exchanges are to occur.⁶³⁵ This was closely followed by the insurance, train and transport industries which require a large number of small scale contracts. Parallel to this development associations, such as the German booksellers' and publishers' association, which was founded in 1825, created standard form contracts for their own industry.⁶³⁶

There are at this point two types of influences on standard terms. The first is where there is an industry network that, funded by the industry, requires standardised transactions for a more efficient operation of the market. The second influence is the government. The government as the main provider of train,⁶³⁷ postal, and later telecommunication services, created general terms that would govern all contracts

⁶³³ Pappenheim, *Handbuch des Seerechts*, vol 3 (Duncker & Humboldt 1918), p. 115.

⁶³⁴ Raiser, *Das Recht der Allgemeinen Geschaeftsbedingungen* (Hanseatische Verlagsanstalt 1935) ,p. 26.

⁶³⁵ There is more information on the rise (and regulation) of the stock exchange in Germany in Ehrenberg, 'Boersenwesen' in *Handwoerterbuch der Staatswissenschaften*, vol 2 (2nd edn, Gustav Fischer 1899), p. 1023 – 1053; Bernhard, *Die Boerse, ihre Geschichte, ihr Wesen und ihre Bedeutung* (S. Simon Verlag 1900).

⁶³⁶ Between publishers, retailers and individual stores but not between the customers and sellers.

⁶³⁷ With some private companies providing train services in the early 1800s; the train services were all nationalised by 1920.

within the individual sector. This would later give rise to a discussion on whether standard form contracts (AGB), being issued by the state, were in fact legal norms without any question as to the fairness (or for that matter incorporation) of the terms.⁶³⁸ In turn this adds weight to this thesis that the courts were in fact only interested in protecting society against monopolistic behaviour and protecting the legal system. The argument here would be that as the standard forms were issued by the state these values must already be protected.

Even with regard to standard terms created by the industry, the courts' approach to dealing with clearly one-sided AGBs was rather tentative. In 1883 the courts refused to provide any sort of relief regardless of how far '*the balance of liability had been shifted in contrast to the natural status*'.⁶³⁹ Such non-intervention by the courts is not surprising as general terms and conditions were seen as a product of economic liberalism,⁶⁴⁰ enhancing free competition between traders. Economic self-interest was the driving force in building the economy. The rise of economic self-interest was based on the motivation for profits and was seen as a necessary driver to uphold the harmony of the economy within Germany.⁶⁴¹ Particularly with a rise of the new middle class and an increase in trade activities from around 1890,

⁶³⁸ Noting here that often it was easier to draft legislation that was automatically incorporated into the contract rather than create AGBs. See Hellwege, *Allgemeine Gerschaftsbedingungen, einseitig gestellte Vertragsbedingungen und die Allgemeine Rechtslehre* (Mohr Siebeck 2010), p. 204 – 208.

⁶³⁹ *RGZ 11, 100* .

⁶⁴⁰ *Ibid.*

⁶⁴¹ Raiser, *Das Recht der Allgemeinen Geschaefstbedingungen* (Hanseatische Verlagsanstalt 1935), p. 15.

Germany experienced a new community-driven leadership. This new force was expressed by trying to create transactions with foreseeable rules – rather than the rulings of judges based often on their personal beliefs. The use of general terms and conditions was therefore a welcome form of harmonisation. Particular areas of business would create standard forms, harmonising the rules within their trade.⁶⁴²

In addition, the courts were also reluctant to intervene because the AGBs were considered similar (or in some cases equal) to legal norms.⁶⁴³ This was mainly due to the mix of standard forms issued by the government and the standard forms used in industry as a summary of the industry norms. Just five years after refusing to provide relief, in 1888 the courts held that the owner of a transport company could not exclude liability for damage to the goods caused by his employees because the general public had no other choice but to use this particular service. In 1888 the court based its decision on AGBs being contrary to good morals and the fact that there was harm to the general public because there was no other party they could contract with.⁶⁴⁴ The fear here was that a monopoly could impose terms on the general public as they wanted. The First World War and the subsequent inflation exaggerated the use of standard terms (and particularly terms that could

⁶⁴² Hellwege, *Allgemeine Gerschaefstbedingungen, einseitig gestellte Vertragsbedingungen und die Allgemeine Rechtslehre* (Mohr Siebeck 2010), p. 2-5.

⁶⁴³ See above.

⁶⁴⁴ It should be noted though that the courts refrained from using this reasoning in later shipping cases (e.g. *RGZ 25, 104*) which also had an effect on other industries (e.g. an insurance case *RGZ 48, 114*).

relieve the business man from the risks) and in the process also created much negative publicity for the government and courts alike.⁶⁴⁵

A factor that will have influenced the court's decision whether or not to intervene was that strict limitations on trade by local associations had only just been lifted. The question was therefore whether these were waves of the new free market which would smooth as competition grew or whether this was a permanent difficulty which needed to be addressed.⁶⁴⁶ This uncertainty would explain the non-interventionist approach by the legislator and the courts. The government changed its position from the neutral stance of allowing the industry to develop, to becoming a leader of industry.⁶⁴⁷ A new spirit of community-driven governance was injected into the German leadership which resulted in economic self-interest being viewed as subject to the greater good of Germany as a state. This in turn allowed for easier intervention in cases of a monopoly exploiting its position as against society. This change in governmental thinking had an impact on the courts' approach to cases of unfair terms. The post-1933 cases still reflect the idea of protection of the public against monopolistic behaviour and also the protection of society as a whole.⁶⁴⁸

⁶⁴⁵ Raiser, *Das Recht der Allgemeinen Geschaeftsbedingungen* (Hanseatische Verlagsanstalt 1935), p. 28.

⁶⁴⁶ Ibid.

⁶⁴⁷ Ibid, p. 16.

⁶⁴⁸ See below Ch. 5.05.

As early as 1928 the courts were willing to intervene (on the basis of §§ 242 and 315 BGB) in cases where an unusual term⁶⁴⁹ was hidden in the AGBs.⁶⁵⁰ The approach that was taken by the courts was that the term was so unusual that the party could not have been taken to have agreed to it. In turn this meant however that if the term had been conspicuous or it could be shown that the party knew or should have known about it then the term would be incorporated into the contract. The case is more important though for two reasons. The first is that the courts were willing to intervene for the first time on the basis that a term was considered unusual (and it would be safe to infer that the term was unfair) and that there was a need to protect parties against unusual terms hidden in the AGBs. The second is that the courts decided that the term was so unusual that it was not incorporated. The reason for intervention may also be found in the theory of first Grossmann-Doerth⁶⁵¹ and later Wagner,⁶⁵² that with the growing acceptance of one-sided AGBs by the public, the weaker party (meaning the consumer) would be educated in two ways. The first was that there would be little point in trying to fight the stronger party. The second was that there would be no reason to believe in the protection supposedly afforded by the BGB as the standard terms would probably override

⁶⁴⁹ Translation from the German: ‚unüblich‘.

⁶⁵⁰ *RG (25.09.1928) BankA 28/185* In Salzer, *Allgemeine Geschäftsbedingungen- Schriftenreihe der Neuen Juristischen Wochenschrift* (C. H. Beck Verlag 1971), p. 86 FN 20.

⁶⁵¹ Grossmann-Doerth, *Selbstgeschaffenes Recht der Wirtschaft und Staatliches Recht: Antrittsvorlesung* (Band 10 Universitaet Freiburg, Breisgau 1933).

⁶⁵² Wagner, *Allgemeine Geschäftsbedingungen- Bestandsaufnahme und Rechtspolitisches Programm* (Dissertationsdruck G. Bauknecht 1973).

them anyway. The consumers (or weaker parties) would therefore come to expect the one-sided AGBs as the norm and to follow the power of the economically wealthier.⁶⁵³ In that same process the consumers (or weaker parties) would lose faith in the legal system which in effect would be allowing a separate, self-sufficient economic legal system that would represent norms that were contrary to the ethos of the BGB (so-called anti-BGB norms). This was the first time that there is acceptance (at least by academics) that unfair terms are harmful to society as a whole.

The courts then gradually began to base their decisions on §138 BGB⁶⁵⁴ which meant that the term had to be contrary to good morals. §138 BGB reads:

(1) A legal transaction which is contrary to good morals is void. (2) In particular, a legal transaction is void by which a person, by exploiting the predicament, inexperience, lack of sound judgment or considerable weakness of will of another, causes himself or a third party, in exchange for an act of performance, to be

⁶⁵³ See *ibid*; p. 12-14; Grossmann-Doerth, *Selbstgeschaffenes Recht der Wirtschaft und Staatliches Recht: Antrittsvorlesung* (Band 10 Universitaet Freiburg, Breisgau 1933); p. 16.

⁶⁵⁴ §138 BGB is tentatively used in *RGZ 20, 115, 117*. In *RGZ 62, 264, 266* the court openly base their decision on §138 BGB: *„[...] der einzelne ein ihm tatsaechlich zustehendes Monopol oder den Ausschluss einer Konkurrenzmoeglichkeit dazu missbraucht, um dem allgemeinen Verkehr unbillige, unverhaeltnissmassige Opfer aufzuerlegen, unbillige und verhaeltnismaessige Bedingungen vorzuschreiben.*‘ Translation: if the individual misuses an actual authority or an exclusion of competition to impose or prescribe unfair or disproportionate obligations on the general public.

promised or granted pecuniary advantages which are clearly disproportionate to the performance.

The difficulty with §138 BGB was that it was aimed at contracts which had as an object something that was contrary to good morals. In contrast if the aim of the contract is not against good morals, being for example for the supply of gas or electricity, it was not sufficient that the freedom of the individual⁶⁵⁵ had been limited until the court decided to broaden the scope of what was to be considered 'contrary to good morals'.⁶⁵⁶ The parameters within which the court was therefore willing to apply the principle was that the use of the AGB was only considered contrary to good morals if the other party had no alternative. In other words, only if there was a monopoly would the court allow a claim under § 138 BGB.⁶⁵⁷ Even if there was a monopoly and the term was considered unfair there was the added difficulty of the term having become customary law or alternatively an industry norm in which case there was no relief for the weaker party.⁶⁵⁸ The implication could be that if a term has become customary law then there is no harm to society as a whole.

⁶⁵⁵ *RG (14.02.31) JW 31/1958* where it was held that it was impossible that the party could have voluntarily agreed to that term; also *RG (25.03.36) JW 36/2093* .

⁶⁵⁶ Raiser, *Das Recht der Allgemeinen Geschäftsbedingungen* (Hanseatische Verlagsanstalt 1935), p. 280.

⁶⁵⁷ Note though that the definition of 'monopoly' broadens over time (i.e. if it was a monopoly within a certain area or to a certain group of people) – see cases such *RGZ 79, 224* .

⁶⁵⁸ Weber, *Die Allgemeinen Geschäftsbedingungen- Eine rechtliche Gesamtdarstellung* (Schweitzer Verlag 1967); p. 197 – 208.

The courts' approach to allowing claims on the basis of § 138 BGB in cases where they had misused their position based on their monopoly (taken from the pre-BGB times) was then not based on the limitation of the individual's contractual freedom but must then be shown to be a misuse of power that was contrary to the public as a whole. Only if the AGB were contrary to the public as a whole (and not only to that individual) due to their monopoly would § 138 BGB be applied by the courts.⁶⁵⁹ There are two aspects which are of particular striking in relation to the courts' decision to use § 138 BGB, the first is that it represents the fear of monopolistic behaviour of that time which is declared to be against good morals⁶⁶⁰ (a less demanding standard than being contrary to good faith) and the second is that in order for it to be against good morals it must affect society as a whole.⁶⁶¹

⁶⁵⁹ Hellwege, *Allgemeine Gerschaefstbedingungen, einseitig gestellte Vertragsbedingungen und die Allgemeine Rechtslehre* (Mohr Siebeck 2010), p. 284.

⁶⁶⁰ At the time there seems to have been a tension between wanting monopolies to avoid cheaper foreign imports (see for example the *Zuendwarenmonopolgesetz* of 1930) where the main aim was to monopolise the sale of matches to avoid the cheaper Soviet imports. In the process though the main producers had attempted to increase their market share by dumping the prices. A further example is monopoly in the marine towing industry (For a complete historic overview see Bieling, *Das Monopol in der Schleppschiffahrt* (Maritime Press 2013)) and wanting to maintain diversity among sellers to offer alternative sources for buyers. In works such as Thalheimer, *Ueber die sogenannte Wirtschaftsdemokratie* (Gruppe Arbeiterpolitik 1928), the author claims that the workers have no influence on the monopolies such as iron works (see p. 13-19).

⁶⁶¹ This is also a product of the time. Falling commodity prices and exorbitant interest payments created a public fear that society may be falling apart. This fear is translated into a value which was carried into the national socialist ideology (where for examples farmers would be supported due to

The wide use of standard terms was not reduced by the national socialist government of 1933 but there was a significant change.⁶⁶² The new structure of the state and economy meant that industry associations were impacted by national socialist ideals. Prices and terms were to be brought in line with the national socialist ideology through economic regulation.⁶⁶³ This was achieved by either creating or taking over trade associations which would create industry-specific terms which they would then impose on the private sector.⁶⁶⁴ These terms set by the associations were seen as universally applicable without the necessity for any reference within the contract.⁶⁶⁵ The consequence was that AGBs issued in this way

their contribution to society as a whole, debts would be written off for the birth of children because children were seen as a contribution to society as a whole) - Schoenbaum, *Hitler's Social Revolution* (Norton 1980) p.100 -110.

⁶⁶² The change was almost immediate with the use of so-called cartels. See Leonhardt, *Kartelltheorie und Internationale Beziehungen: Theoriegeschichtliche Studien* (Georg Olms Verlag 2013), p. 210 – 250.

⁶⁶³ See for example Larenz, *Vertrag und Unrecht: Teil 1- Vertrag und Vertragsbruch* (Hanseatische Verlagsanstalt 1936); p. 33.

⁶⁶⁴ Examples include AGBs for the sale of potatoes, sweets, honey, sugar, vegetables, fruits etc. (for a more detailed list see Haupt, *Die Allgemeinen Geschäftsbedingungen der deutschen Banken* (Leipzig 1937), p.209).

⁶⁶⁵ [...] *wichtig ist in allen Fällen, dass die auf Grund dieser Bestimmungen entstandenen AGB für allgemein Verbindlich erklärt werden können, so dass sie also im Verhältnis zwischen Unternehmen und Kunden gelten, ohne dass einer rechtsgeschäftlichen Einigung darüber bedarf. [...]ibid, p.201.*

were not considered contractual agreements but legal norms and as such were considered fair.⁶⁶⁶

5.03 German Law after 1935

In 1935 Raiser published his work on the use of unfair terms. He criticised the fact that the courts for failing to distinguish between cases of procedural unfairness (i.e. whether the term was incorporated) and unfairness as to the substance of the term. This statement seemed to go unheard for many years. However, Raiser's summary (and commentary) of the law on unfair terms did provide a foundation for renewing the system. There were several difficulties facing the courts. The first was that it was apparent that §138 BGB would only catch cases where there was a monopoly but not cases where all competitors were using the same kind of terms. The second was that the national socialist era had left a legacy of norm-like terms and conditions including the ease with which these could be included in the contract. In brief, as long as the other party knew or should have known that AGBs existed, they were automatically incorporated into the contract.⁶⁶⁷ However, this rule only applied in cases where the AGBs could reasonably be expected to be included. In cases where the reasonable party would not expect the term to be included, it could only be included by express reference to that term.⁶⁶⁸ The

⁶⁶⁶ Not entirely without criticism. In 1863 v. Geber and shortly after Mittermaier had mentioned that AGBs were misinterpreted as legal norms – see Hellwege, *Allgemeine Gerschaftsbedingungen, einseitig gestellte Vertragsbedingungen und die Allgemeine Rechtslehre* (Mohr Siebeck 2010), p. 213; also see the development of the argument of legal norms in this section, below.

⁶⁶⁷ See for example *RGZ 103, 405* ; *RGZ 114, 282* .

⁶⁶⁸ *RGZ 103, 84* ; *RGZ 112, 253* and later *BGHZ 17, 03* .

difficulty with this approach was that if the whole industry was using similar terms (whether fair or not) they would automatically be included in the contract.

The third was that even though Raiser had proclaimed that the tool in every judge's toolbox was to interpret the AGB against the person relying on them,⁶⁶⁹ the general rule had been to establish the proclaimer's will or at the very least the will of both parties.⁶⁷⁰ For example in the *Betting Shop Case*,⁶⁷¹ the back of a betting ticket that the claimant had bought from an agent of the betting shop excluded all tickets that had not been received by head-office. In this case two of the three tickets handed in by the claimant were sent to the head office (the third and vital ticket was later found at the agent's office). The court held that due to the principle of restriction the term only applied to cases where the claimant should have had reason to believe that the agent would not send his bet to head-office.⁶⁷² Schmidt-Salzer later added that in cases where the AGB were restricting provisions of the BGB, they should always be interpreted very narrowly.⁶⁷³ This approach was accepted as the principle of 'restriction'.⁶⁷⁴ For example, if the purchaser of property has made it

⁶⁶⁹ Raiser, *Das Recht der Allgemeinen Geschäftsbedingungen* (Hanseatische Verlagsanstalt 1935), p. 265.

⁶⁷⁰ See Hellwege, *Allgemeine Geschäftsbedingungen, einseitig gestellte Vertragsbedingungen und die Allgemeine Rechtslehre* (Mohr Siebeck 2010), p.126.

⁶⁷¹ BGHZ 5, 111, 115.

⁶⁷² See also BGH NJW 1968, 591.

⁶⁷³ Salzer, *Allgemeine Geschäftsbedingungen- Schriftenreihe der Neuen Juristischen Wochenschrift* (C. H. Beck Verlag 1971), p. 83.

⁶⁷⁴ E.g. BGHZ 22, 90; BGH NJW 1959, 38.

clear that the reason he is buying the property is to build on it and the contract contains a term that any claim for visible or invisible defects of the property is excluded, the exclusion would not apply if the buyer later found out that he could not build on the property – this would not be considered a defect.⁶⁷⁵

§242 BGB and Standard Terms

Even at the beginning of the 1950s the idea of some AGBs being considered legal norms still lingered. The BGH finally rejected the idea in 1951 and allowed for a fresh approach to evaluating the fairness of standard terms.⁶⁷⁶ The court reiterated this approach in a 1953 case where it was claimed that the general terms for freight forwarders⁶⁷⁷ had been included in a forwarding order without the consent of the other party. The argument was that because they had a norm-like character they were automatically included. The courts rejected the suggestion that the other party must know (or at least should have known) that the terms were included.

The use of § 242 BGB became essential in the new approach to evaluating standard terms mainly because of the limits of § 138 BGB. The approach to unfair terms under § 138 BGB was focussed on the procedure through which the contract was entered into (i.e. did the other party use his monopoly to force the other party to accept the terms). There was little scope for evaluating whether the substance of a

⁶⁷⁵ *BGH NJW 1964, 356*, at 358. This statement was made *obiter dictum* as the contract was signed in the presence of a notary public in which case the standard terms and conditions would not be classed as a one-sided but are then classed as an individually negotiated contract.

⁶⁷⁶ *BGHZ 03, 200; BGH MDR 1953, 353*.

⁶⁷⁷ *Allgemeine Deutsche Spediteurbedingungen*.

term was unfair. In 1953 the court considered how deviations from the existing law should be considered. It should be remembered here that the protection of the underlying values of the BGB was an important element in the rise of § 138 BGB.⁶⁷⁸

The first tentative approach was made in 1953. § 340 (2) BGB states that '*if the obligee is entitled to a claim in damages for non-performance, he may demand the penalty as the minimum amount of the damage. Assertion of additional damage is not excluded.*' The court confirmed that this provision could be deviated from by the parties will.⁶⁷⁹ However, the court also held that the parties could not do so in the general terms and conditions. This followed from the fact that the party using standard form contracts was claiming the freedom of contract for themselves. In doing so, the court held, that they had a heightened obligation to take their future contractual parties' interests into account. In other words, if the party is intending to use standard form contracts they must take the other party's interests into account when drafting the clause.

This was the first time that the court had moved away from the approach that the term must be known to the other party to make an informed decision to an obligation to take into account the other party's interests. Just three years later the court decided to base their entire decision on §242 BGB rather than on §138

⁶⁷⁸ This was first mentioned in Ch. 5.01 above but will be developed further in the course of this chapter.

⁶⁷⁹ See *BGH GRUR 1953, 262* .

BGB.⁶⁸⁰ In the *bedroom purchase case*⁶⁸¹ the court made it clear,⁶⁸² with particular reference to Raiser's work, that it was not sufficient that the term was unfair in this particular case for this individual but it must be generally unfair to the average buyer. Only this would justify the courts in analysing the substantive fairness of the particular agreement:⁶⁸³

*It can be concluded that in cases of new furniture that the exclusion of buyer's statutory warranties can be included in standard form contracts if the buyer is provided with a right to repair or replacement. [...] A differing design of the standard terms cannot be brought in harmony with the principle of good faith [...]*⁶⁸⁴.

⁶⁸⁰ or in some cases a combination of both.

⁶⁸¹ BGHZ 22, 90 (*Bedroom Purchase Case*) .

⁶⁸² Ibid. at 98: „[...] sowie auf die Interessen der an einem solchen Kauf üblicherweise beteiligten Verkäuferschicht und Käuferschicht, nicht aber auf die individuellen Belange der in dem Einzelfall an dem konkreten Vertrag gerade beteiligten Vertragspartner ankommt.“ – Translation: [...] as well as the interests of the particular group of sellers and particular group of buyers that should be taken into account but not the individual interests of the particular case which only relates to the particular contract to which the parties are bound.

⁶⁸³ Note here though the criticism by Hellwege that if protection of the general 'good' were the objective then the court should be allowed to evaluate the adequacy of the price, which the courts refuse. (See Hellwege, *Allgemeine Geschäftsbedingungen, einseitig gestellte Vertragsbedingungen und die Allgemeine Rechtslehre* (Mohr Siebeck 2010); p. 540 – 546).

⁶⁸⁴ Translation of BGHZ 22, 90 (*Bedroom Purchase Case*) at 98: „Zusammenfassend ergibt sich daraus, daß bei einem Kauf fabrikneuer Möbel der Ausschluß der Gewährleistungsansprüche durch die allgemeinen Lieferungsbedingungen des Käufers zwar generell vorgesehen werden kann, wenn dem

It seems that the influence of Raiser's work and his criticism of the use of § 138 BGB and the national socialist ideologies of protecting society against unfair terms was carried into the court's values of the 1960s.

In the *Bedroom Purchase Case*⁶⁸⁵ the defendant (buyer) had bought bedroom furniture. A credit agreement was drawn up by the claimant (an intermediary) and entered into by Gefa (the fourth party). The credit agreement excluded the purchaser's right to withhold performance (i.e. payment) in case of a defect. The goods arrived and were damaged. The defendant (the buyer) refused to pay the instalments until the defect was cured. Upon defaulting on the payments Gefa sold the credit agreement to the intermediary who then brought this claim. The court balanced the interests of the claimant (to be able to uphold the contract) against the buyer's interest in receiving undamaged goods (and therefore being able to enforce that right by withholding payment). The court held that the buyer's interests outweighed those of the seller on the basis of good faith. It would seem that the court's main concern was then the balance of the interests of the parties as a foundational principle of the contractual arrangement on the proviso that this

Käufer statt dessen ein Nachbesserungsrecht eingeräumt ist, daß aber die Gewährleistungsansprüche des Käufers aufleben, wenn sich das Nachbesserungsrecht aus irgendeinem Grunde nicht realisieren läßt. Eine andere Gestaltung der Lieferungsbedingungen läßt sich mit den Grundsätzen von Treu und Glauben nicht vereinbaren, weil dies zu einer rechtlich unhaltbaren, weil rechtlich unbilligen Belastung des Käufers führen würde, die nicht hingenommen werden kann. In dieser Hinsicht bestehen deshalb für den Inhalt der Lieferungsbedingungen gemäß § 242 BGB zwingende Schranken. '

⁶⁸⁵ Ibid.

affects society as a whole.⁶⁸⁶ In other words the restriction on withholding buyers' payments in general was contrary to good faith. The court also accepted that § 242 BGB (rather than § 138 BGB) was the dominant provision to deal with unfair terms.⁶⁸⁷

The *Sunken Ship Case*⁶⁸⁸ showed that this approach by the courts did not apply universally but that it might be limited to consumer contracts. Here, the contract was for the security of two ships. The defendant had contracted to provide security patrols at the docks in Hamburg. Company X, who was insured with the claimant, had left two ships at the docks to be watched by the defendant. The first ship sank in the bay where the company had left it, the second ship was moved by the defendant and later sank there. The defendant claimed that their responsibility for the damage (or loss) of the ships was limited to 300 Reichsmark.⁶⁸⁹ The claimant argued that the reason the ships sank was due to the negligence of the staff and that therefore the exclusion clause did not conform to the principle of good faith, particularly in light that there was no other company offering this service in Hamburg.

The court acknowledged, in the *Bedroom purchase case*, that generally a reduction in cost could not justify the exclusion⁶⁹⁰ but that in this case the factor could be

⁶⁸⁶ Similarly see *BGH NJW 1975, 163 (Burgled Pub Case)* at 164.

⁶⁸⁷ This problem would now be dealt with under §§ 358 and 359.

⁶⁸⁸ *BGHZ 33, 216 (Sunken Ship Case)*..

⁶⁸⁹ Note that the standard terms were from 1937, hence the loss was limited to Reichsmark.

⁶⁹⁰ *BGHZ 22, 90, 98*

taken into account.⁶⁹¹ The reason was that in the industry it was common for ship owners to have insurance to cover the loss of the ship and the reduced price therefore made business sense. More importantly the court went on to discuss how the AGBs should be interpreted. The first test is whether generally, to a reasonable person, the terms and conditions were fair and could be expected⁶⁹² to be included in these types of contract.⁶⁹³ The second test was whether in this particular contract a term which was usually reasonable could still be contrary to good faith. The court concluded that due to the fact that it was normal in the industry for the other party to have insurance, this clause was not contrary to good faith.⁶⁹⁴ The focus for the court was therefore first and foremost on whether the term in itself was fair in substance and then to evaluate whether the term was expected in this

⁶⁹¹ BGHZ 33, 216 (*Sunken Ship Case*), 220

⁶⁹² The line of thought here is that the other party only consented (in line with § 242 BGB) for the AGBs to be included which he could reasonably expect to be included under the circumstances.

⁶⁹³ BGHZ 33, 216 (*Sunken Ship Case*) , 218 expanding on the analysis in BGHZ 7, 365 , 368.

⁶⁹⁴ Summary of the courts decision at the end of para 2: *„Notwendig, aber auch genügend ist bei Vertragsschluß die Einigung dahin, daß die von einem Vertragspartner aufgestellten Geschäftsbedingungen gelten sollen (ohne daß der andere Vertragsteil sie im einzelnen zu kennen braucht); der Unterwerfungswille des anderen Teils bezieht sich aber gem. §242 BGB nur auf solche Bedingungen, mit deren Aufstellung er billiger- und gerecht erweise rechnen kann (BGHZ 17, 1, 3; NJW 55, 1145). Dies erfordert eine Abwägung der Interessen der normalerweise für solche Geschäfte beteiligten Kreise (BGHZ 22, 90, 98; NJW 57, 17). Ist eine unter diesen Gesichtspunkten geprüfte Klausel nicht zu beanstanden, so kann dennoch die Berufung auf sie im Einzelfall eine unzulässige Rechtsausübung darstellen und durch die Zulassung dieses Einwandes den Umständen des Einzelfalles Rechnung getragen werden [...]‘.*

type of contract. A term which in itself seems unfair can still be held to be fair if it was expected to be included in such a contract – e.g. because the parties are expected to be insured.

The *sunken ship case* confirms the values of ‘protection of society’ and ‘protection against monopolistic behaviour’ because if in these type of cases it is the norm that the party has insurance then society is automatically protected. Similarly, there is no reason to protect the parties from the monopolistic behaviour because the party is protected by insurance.

In 1964 the courts decided to find an alternative explanation on the basis of the individual’s private autonomy (combined again with the deviation from statutory rules). In the *Storage Destruction Case*⁶⁹⁵ the AGBs had reversed the burden of proof by making the customer prove that the owner of the storage facility was at fault for the damage. It was impossible for the person storing their goods to show that it was the storage owner’s fault because the goods were out of his control.

The presumption would usually be that if the goods are with the storage owner, he would have to prove that it was not his fault if the goods were damaged whilst they were stored there. The courts argued here that the individual’s private autonomy had been destroyed due to the submission to the contract which justified the courts interference. The court held that there was an imbalance in the contract and that therefore the clause was invalid. Here the court relied more on the private individual’s autonomy than on the argument of protecting society as a whole in

⁶⁹⁵ BGHZ 41, 151 (*Storage Destruction Case*) .

order to allow the court to review the standard terms.⁶⁹⁶ The fairness of the terms was then to be measured against the degree to which the dispositive law was aimed at protecting societal values as opposed to considerations of expediency.⁶⁹⁷ In this case the protection of the dispositive law (or the BGB) trumped the contractual terms because the remedies had been entirely removed by the contractual provisions. The reasoning in the case is reminiscent of the above arguments that were originally put forward – namely the loss of faith in the legal order if the protections in the BGB can be circumvented by contractual provisions to any degree.⁶⁹⁸

⁶⁹⁶ This was a summary of the courts argument under para III: *„Da Allgemeine Geschäftsbedingungen ihre Rechtswirksamkeit nicht von einer (nicht bestehenden) Privatautonomie, sondern nur von der Unterwerfung des anderen Vertragsteils ableiten können, muß ihnen die Anerkennung versagt werden, soweit die von ihnen für eine unbestimmte Anzahl von Einzelfällen aufgestellte Regel mit den Grundsätzen von Treu und Glauben nicht zu vereinbaren ist.“*

⁶⁹⁷ This was a summary of the courts argument under para III: *„Soweit Vorschriften des dispositiven Rechtes ihre Entstehung nicht nur Zweckmäßigkeitserwägungen, sondern einem aus der Natur der Sache sich ergebenden Gerechtigkeitsgebot verdanken, müssen bei einer abweichenden Regelung durch Allgemeine Geschäftsbedingungen Gründe vorliegen, die für die von ihnen zu regelnden Fälle das dem dispositiven Recht zugrunde liegende Gerechtigkeitsgebot in Frage stellen und eine abweichende Regelung als mit Recht und Billigkeit vereinbar erscheinen lassen. Der Gerechtigkeitsgehalt der vom Gesetzgeber aufgestellten Dispositivnormen kann verschieden groß sein. Je stärker er ist, ein desto strengerer Maßstab muß an die Vereinbarkeit von Abweichungen in Allgemeinen Geschäftsbedingungen mit dem Grundsatz von Treu und Glauben angelegt werden.“*

⁶⁹⁸ See Ch. 5.02.

There are therefore two values that the courts have considered in this case: protection of society and the individual's autonomy. A fundamental value of the BGB is the protection of the individual's autonomy/will.⁶⁹⁹ The approach taken by the courts may therefore be considered a widening of the doctrine on unfair terms in order to review terms which are unfair because they create a significant imbalance in the parties' obligations (substantive unfairness). The conclusion would be that where there is a significant imbalance in the parties' obligations due to the standard terms of the contract the court would consider the content of the term contrary to good faith on the basis that the individual's will has been limited (noting here though that the court will still measure the fairness on the basis of the protection of society as a whole).

The notion in the *Storage Destruction Case*⁷⁰⁰ of protecting private autonomy also had an influence on later cases. In the *Confusing Slot Machine Case*⁷⁰¹ the AGBs contained a clause that if the slot machines were not set up correctly on the premises of the other party, 20 DM would have to be paid each day until the end of the contract. The owner of the pub refused to set up the slot machines (for unknown reasons). The contract had been structured in a particularly confusing way by jumbling all the terms and omitting any headings and sub-headings. It was argued that the contract had been 'structured' in this way to ensure that the other party would have to pay special attention to the AGBs. The court rejected this idea

⁶⁹⁹ See particularly Ch. 3.13.

⁷⁰⁰ BGHZ 41, 151 (*Storage Destruction Case*) .

⁷⁰¹ BGHZ 51, 55 (*Confusing Slot Machine Case*) .

and found that the contract was contrary to § 138 BGB – against good morals.⁷⁰²

The basis of the decision⁷⁰³ was that because one of the parties had imposed the terms on the other party – this was particularly apparent because the AGBs had been designed not to be understood by the other party - and had therefore claimed the freedom of contract for themselves, there was a duty on that party to have reasonable regard for the other party's interests. The difficulty in this case was that the term itself was not in fact contrary to good faith – it was a simple penalty clause.⁷⁰⁴ Previously § 138 BGB had required there to be a monopoly but due to the *Storage Destruction Case*⁷⁰⁵ the courts could now argue that the contract was contrary to good morals because it did not consider the interests of the other party. An added benefit of using § 138 BGB in this case was that the court could hold that the whole contract was void.

In the *Greedy Accountant Case*⁷⁰⁶ the German Supreme Court held that a term that was contrary to good faith because it was surprising and unfair would not have been incorporated into the contract. In the case the defendant had transferred his tax matters to a tax consultant under a mandate that referred to the consultant's standard terms of business. These standard terms set out that if the mandate was revoked prematurely the full sum would be payable regardless of the work that had

⁷⁰² See Ch. 5.02 above.

⁷⁰³ BGHZ 51, 55 (*Confusing Slot Machine Case*) , 59.

⁷⁰⁴ Which are legitimate in German law (§§ 339 BGB ff).

⁷⁰⁵ BGHZ 41, 151 (*Storage Destruction Case*) .

⁷⁰⁶ BGHZ 54, 105 (*Greedy Accountant Case*) .

been done. The court held that the term was so surprising and one-sided that the defendant could not be held to have agreed to that term.⁷⁰⁷ The court took a two-step approach. First, it considered whether the term was surprising (procedural fairness) and later whether the substance of the term was unfair (substantive unfairness): *'It is settled case law that the person who relies on standard terms assumes for himself control over the general freedom of contract as far as the content of the contract is concerned. He is therefore obliged at the stage of drafting those standard terms to look to the reasonable protection of the interested of his future contractual partners.'* The court then went on to consider the fairness of the remuneration and held that *'it is true that it is not unacceptable as such that, according to the substance of § 17 ALLGO [their standard terms], the agent can and should retain the complete remuneration in the event of early revocation [...]'*. The court went on to hold that *'the clause does not, however, accord with the principle of good faith, because in setting the level of the remuneration claim[...] it pays no attention at all to the extent to which services have actually been provided [...]'*.

The philosophy the court seems to be upholding is that the individual should be able to enter into a standard form contract without having to expect any unusual terms to be contained therein. Even if the term is held to be unusual the court then has to review the substance of the term whether this term would generally be considered unfair. The idea that terms which are considered unusual in the

⁷⁰⁷ For a translation of the relevant part of the case Beale and others, *Contract Law: Ius Commune Casebooks for Common Law of Europe* (2nd edn, Hart Publishing 2010), p.764.

particular contract are held not to have been incorporated into the contract is now included in § 305c (1) BGB:

Provisions in standard business terms which in the circumstances, in particular with regard to the outward appearance of the contract, are so unusual that the other party to the contract with the user need not expect to encounter them, do not form part of the contract.'

In 1975, in the *Burgled Pub Case*,⁷⁰⁸ the defendant, the owner of a pub, was contractually obliged to keep gaming machines in operation for several years. The contract stated that if in breach of this provision, the defendant had to pay 2,000.00 DM in damages and whatever profits would have accrued. These terms were contained in the general terms and conditions. The pub was broken into and shortly after was also burgled. During the burglary the machines were damaged and the defendant then decided not to re-open the pub. The question was whether the claimant was entitled to 2,000.00 DM and the loss of profit. The court held that generally agreeing on a fixed sum of damages in a contract promoted certainty and efficiency but that the provision declaring that the 2,000.00 DM did not influence the additional payment of all damages was contrary to good faith in light of § 340 (2) BGB.⁷⁰⁹ The fact that the 2,000.00 DM were in addition to the damages arising

⁷⁰⁸ BGH NJW 1975, 163 (*Burgled Pub Case*) .

⁷⁰⁹ § 340 BGB reads: (1) *If the obligor has promised the penalty in the event that he fails to perform his obligation, the obligee may demand the penalty that is payable in lieu of fulfilment. If the obligee declares to the obligor that he is demanding the penalty, the claim to performance is excluded.* (2) *If*

from the breach, in this case 1,852.62 DM, meant that this was an exploitation of the other party.

The court did not address whether the term was surprising but considered whether the term was unfair. The court balanced the benefit of expedience and the potential losses and came to the conclusion that the clause created a windfall for the creator of the standard terms without any benefit to the other party. In other words the claimant will have to show that there are more than just considerations of expedience that override the justice set up by the existing statutory law. The nature of § 340 (2) BGB, the court continued, is to balance the interests of the parties and could therefore not be excluded in this case.⁷¹⁰ The test for whether the term can or cannot be excluded in standard form contracts is whether the interests of the other party are sufficiently protected.⁷¹¹

In the case of the '*greedy accountant*'⁷¹² the court held that if the creator of the AGBs decided to limit the dispositive law only in his favour, thereby neglecting the interests of the other party, he was misusing the freedom of contract which in turn legitimises the courts intervention. It would seem that the development of the cases show how the courts have reviewed cases in two different ways. The first are cases where there is a monopoly (or quasi-monopoly) and the term is considered

the obligee is entitled to a claim to damages for non-performance, he may demand the penalty payable as the minimum amount of the damage. Assertion of additional damage is not excluded.

⁷¹⁰ See also BGHZ 22, 90 (*Bedroom Purchase Case*) discussed above.

⁷¹¹ BGH NJW 1975, 163 (*Burgled Pub Case*) , 164.

⁷¹² BGHZ 54, 105 (*Greedy Accountant Case*) , 109.

unfair in substance. The second approach is where the term is surprising and unfair in substance.⁷¹³

5.04 German Law and the AGBG 1975

The Bundestag (the German parliament) published its suggestion of the AGBG (the act on standard form contracts) in August 1975.⁷¹⁴ The suggestions by the Government acknowledge that there had been a shift from the small business on an individual basis with a 'model of self-regulation of the economy'⁷¹⁵ to imposed standardised contracts. The basis for the hands-off approach by the government in years prior to the reform had been, similarly to that in England, that of freedom of contract of the individual⁷¹⁶ and most likely the expectation of self-regulation.⁷¹⁷

The final AGB Gesetz in essence followed the recommendations of the Deutschen Juristentag (the German jurists' conference) in that it did not limit its application to consumer contracts but also included business-to-business contracts. It thereby rejected the proposal of socialist legal theorists for an independent consumer code.⁷¹⁸ It also rejected the proposal of an inspection of AGBs prior to their use by government

⁷¹³ Note that where a clause is found to be surprising it is sufficient under § 305 c BGB for the clause not to be included without the requirement of the clause being unfair.

⁷¹⁴ *BT Drucksache 7/3919 (Bericht des Rechstausschusses - 6. Ausschuss) (1975).*

⁷¹⁵ *Ibid*; p. 9: '[...]hatte in einer weithin von Handwerk und Kleingewerbe geprägten Wirtschaftsordnung das ,Modell einer sich selbst regulierenden Harmonie des ökonomischen Geschehens noch eine reale Grundlage [...]'.
Wirtschaftsordnung das ,Modell einer sich selbst regulierenden Harmonie des ökonomischen Geschehens noch eine reale Grundlage [...]'.

⁷¹⁶ *Ibid* .

⁷¹⁷ See above Ch. 5.02.

⁷¹⁸ See Hellwege, *Allgemeine Gerschaeftsbedingungen, einseitig gestellte Vertragsbedingungen und die Allgemeine Rechtslehre* (Mohr Siebeck 2010),p. 313-320.

agencies.⁷¹⁹ However, the Federal Cartel office would hold copies of AGBs which were claimed by consumer associations (and related agencies) to be unfair. The main reason for intervention is the disparity in the party's protected interests in the standard terms which justify the intervention by the courts. The implementation of the AGB-Gesetz followed the case law that had arisen first from § 138 BGB and then later from § 242 BGB⁷²⁰, where the courts had previously held that in some cases standard contracts contained clauses that were contrary to good faith.

5.05 German Law: Ex post facto justifications or value based judgments?

The justification of the intervention

Much of Raiser's argument was based on the protection of society and as we have seen above this is what the courts (as far back as the 1800s) based their decisions on. The idea was that if a term of the AGB was merely unfair to a particular individual in that case then the claim would fail. However, if the term was considered generally unfair then the claim would succeed. Interestingly the courts would not consider the price to be unfair under any circumstances.⁷²¹ The idea that society as a whole needed protection against unfair terms seems to have arisen though from the early judgments and became a lot stronger in later cases.

The idea of the protection of society fits in particularly well with the national socialist ideologies of the 1930s and 40s. The protection of society as an ideology is

⁷¹⁹ Ibid.

⁷²⁰ See above Ch. 5.03.

⁷²¹ Note though that the price may be considered unfair under particular circumstances that fall within §138 (2) BGB.

represented by an increase in the number of AGBs that were approved or often imposed by trade associations controlled by the government during this time.⁷²² This approach also resonates in the suggestions put forward for the AGB Gesetz that there should be a government agency responsible for approving AGBs, which was ultimately rejected. What did remain was a general opportunity for competitors to bring claims against each other in case one of them was using unfair standard terms.

Schmidt-Salzer attempts an approach based on the individual's freedom of contract.⁷²³ If the contract is negotiated individually, the foundation of the contract is that the parties did so in full knowledge of the consequences. The parties are therefore fully responsible for their side of the bargain.⁷²⁴ He argues that the difference with the AGBs is that these go beyond the individual party's responsibility in that only one side has taken the responsibility of drafting the clauses on a 'take it or leave it' basis. The contract is therefore unilateral, rather than bilateral, in terms of its construction and its terms can therefore not be classed as contractual terms that have been checked by the other party. The fact that the contract has not been negotiated individually may not be relevant from a

⁷²² Salzer, *Allgemeine Geschaeftsbedingungen- Schriftenreihe der Neuen Juristischen Wochenschrift* (C. H. Beck Verlag 1971), p. 14-16.

⁷²³ Ibid, p. 16.

⁷²⁴ There may be exceptions to this if the contract is particularly one sided see Markesinis, Unberath and Johnston, *The German Law of Contract: A Comparative Treatise* (2nd edn, Hart Publishing 2006), p. 254 -260.

legal point of view per se but is an important social factor which in turn justifies the creation of a special set of norms.⁷²⁵

According to Schmidt-Salzer's analysis above, the courts must consider the AGB as being one-sided, independent of the individual's circumstances and intentions. In other words the courts are justified in interpreting AGBs differently from normal terms of a contract⁷²⁶ as there was no negotiation (and therefore they are not the result of negotiations).⁷²⁷ The courts will not have to apply the usual rules of construction because the other party cannot be seen as having influenced the contract. However, the approach by the courts seems to be motivated by the need to protect society balancing this against freedom of contract. Originally there was a presumption that the AGBs were so universally applicable within fields that they had reached (or in some cases were meant to reach) the status of a norm.⁷²⁸ The courts then decided to intervene in cases where the AGBs were contrary to statutory provisions. The idea was based on the fact that the statutory provisions

⁷²⁵ Salzer, *Allgemeine Geschäftsbedingungen- Schriftenreihe der Neuen Juristischen Wochenschrift* (C. H. Beck Verlag 1971) p.16.

⁷²⁶ For an analysis of the usual interpretation see Larenz and Canaris, *Methodenlehre der Rechtswissenschaft* (3rd edn, Springer Verlag 2008); Chapter 4 (3) (g).

⁷²⁷ Not though that this does not mean that the courts will neglect to take into consideration the relationship between the individually negotiated part of the AGBs. The courts will have to consider the AGBs in light of the individually negotiated part. (see also Salzer, *Allgemeine Geschäftsbedingungen- Schriftenreihe der Neuen Juristischen Wochenschrift* (C. H. Beck Verlag 1971) para. 111).

⁷²⁸ Ibid

were considered the balanced approach. Grossmann-Doerth⁷²⁹ argues that if one of the parties has the privilege of setting up terms that are then considered norms he is acting as a legislator.⁷³⁰ On that basis he has the same duties as a legislator to create norms that are considered fair to society as a whole.⁷³¹ In fact this argument was put forward slightly differently in *Storage Destruction Case*⁷³² where the court argued that due to one of the parties having the privilege of creating the AGBs they have a duty to take the other party's interests into account. In fact combined with Raiser's argument that the court has a right to intervene in order to protect society as a whole it can now be argued that the court's developed a duty on the user of standard form contracts to protect society by taking into account the wide range of potential parties upon whom the standard for may be imposed.

It was shown above that the courts also had an interest in protecting the legal system itself.⁷³³ If anyone can contract out of the dispositive law through their terms then the individual will lose faith in the protection that is meant to be provided by the dispositive law. The parties that would therefore be exploited the

⁷²⁹Grossmann-Doerth, *Selbstgeschaffenes Recht der Wirtschaft und Staatliches Recht:*

Antrittsvorlesung (Band 10 Universitaet Freiburg, Breisgau 1933), p. 544.

⁷³⁰ See Ch. 5.02.

⁷³¹ See BGHZ 51, 55 (*Confusing Slot Machine Case*) or BGHZ 54, 106 p. 109.

⁷³² BGHZ 41, 151 (*Storage Destruction Case*) .

⁷³³ See Ch. 5.03.

most are the least fortunate and least informed. Such provisions are therefore contrary to the social state principle.⁷³⁴

Early writers identified that most commonly liability for faulty goods or services would be limited or excluded.⁷³⁵ The impact on society would therefore be to encourage negligent work by shifting the risk to the other party.⁷³⁶ This in turn influenced the courts to look particularly to those parties at a disadvantage to restore the balance that the dispositive law had created with the social state principle in mind. Three categories of imbalance have led the courts to intervene. The first category are cases where there is an informational imbalance.⁷³⁷ This can occur either in cases where one party is not aware of the standard exclusions of a particular industry⁷³⁸ or where one party is unable to understand the consequences of the terms because for example they have been hidden within the contractual

⁷³⁴ Hellwege, *Allgemeine Gerschaefstbedingungen, einseitig gestellte Vertragsbedingungen und die Allgemeine Rechtslehre* (Mohr Siebeck 2010), p.554 .

⁷³⁵ See the examples in Wagner, *Allgemeine Geschäftsbedingungen- Bestandsaufnahme und Rechtspolitisches Programm* (Dissertationsdruck G. Bauknecht 1973), p. 13.

⁷³⁶ Ibid.

⁷³⁷ Larenz and Wolf, *Allgemeiner Teil des Buergerlichen Rechts* (9th edn, Mohr Siebeck 2004), §42 RN 8.

⁷³⁸ Note though the simple fact that the other party was not aware is insufficient. There is also the possibility of § 138 (2) BGB applying in cases where the party was exploited due to their ignorance (this will not be discussed further here because it would need an excursion into the law of unconscionability).

document.⁷³⁹ The second category of cases are those where there is an economic imbalance. This category is in essence the broader monopoly argument mentioned above. The economically disadvantaged party is unable to negotiate different terms or to choose a competitor since either there is a limited market that is covered by similar terms or there is only one party.⁷⁴⁰ The final category is the situational imbalance.⁷⁴¹ The situational imbalance arises in cases where one party has time (and often legal guidance) to create the terms (even in one-off contracts) whereas the other party is then presented with the terms and given little time (or they do not have the capacity) to understand the terms in a way that they could present changes to those terms. This final point could apply to business-to-consumer contracts as well as to business-to-business contracts.

5.06 English Law – Overview

The early nineteenth century saw an increase in the use of standard term contracts in England and with it also an increase in the use of exclusion/limitation clauses. Standard form contracts were seen⁷⁴² as a welcome form of increasing efficiency to

⁷³⁹ There were some early attempts to remedy these cases via § 119 BGB but this approach was rejected shortly after the publication of Raiser's book.

⁷⁴⁰ For § 138 (2) BGB to apply the legislator now provides that there must be a significant imbalance.

⁷⁴¹ Larenz and Wolf, *Allgemeiner Teil des Buergerlichen Rechts* (9th edn, Mohr Siebeck 2004), §42 RN 9.

⁷⁴² And are still considered today (See Kessler, 'Contracts of Adhesion- Some thoughts about Freedom of Contract' (1943) 43 Columbia Law Review at p. 631; Beale, 'Unfair Contracts in Britain and Europe' (1989) 42 Current Legal Problems 197, p. 203-204.

support industrialisation.⁷⁴³ The use of exclusion clauses was merely seen as part and parcel of freedom of contract and a way for businesses better to apportion the risk.⁷⁴⁴ In fact this idea carried through in later cases where the courts at least paid lip service to this ideology.⁷⁴⁵ This period of non-intervention soon shifted to a phase (from around 1885⁷⁴⁶ to the 1920/30's) where judges were generally hostile towards exclusion clauses. This manifested itself in variety of ways in which judges

⁷⁴³ Yates, *Exclusion Clauses in Contracts* (2nd edn, Sweet & Maxwell 1982), p. 1; Mulcahy, *Contract Law in Perspective* (Routledge Cavendish 2008), p. 161 – 163.

⁷⁴⁴ Kessler, 'Contracts of Adhesion- Some thoughts about Freedom of Contract' (1943) 43 *Columbia Law Review* at p. 631; Also see the definition of risk in this context Yates, *Exclusion Clauses in Contracts* (2nd edn, Sweet & Maxwell 1982), p. 1; Mulcahy, *Contract Law in Perspective* (Routledge Cavendish 2008), p.2-5.

⁷⁴⁵ E.g. in *Carr v Lancashire & Yorkshire Railway* [1852] 7 Ex 707 (CE), at 715/716: [...] *if a special contract be entered into by him and the party sending the articles to be conveyed, both sides are bound by the terms of the contract. The Carriers Acts says that a special contract may be made. If that be so, all that we have to do is to see what that contract is. [...] the parties who have the care of such goods may contract that they will not be answerable for their own gross negligence.*'; or in *Gallin v London & North Western Railway Co* 1874-75 LR 10 QB 212 (QB), where the court held that when the train company excluded all liability for loss or personal injury 'in transit' this must also include the platform.

⁷⁴⁶ However, there are some examples of quite the opposite. In the case of *McCarten v North Eastern Railway Co* [1885] 54 Law J Rep QB 441 the judges held that the companies are so well advised that they must have intended to avail themselves from any liability and therefore had done so in this case.

would find either the exclusion clause was not included in the contract,⁷⁴⁷ should be interpreted as not to cover this particular breach,⁷⁴⁸ was not clear enough,⁷⁴⁹ or could not be effective because they were excluding fraud.⁷⁵⁰ The difficulty with this approach was that if (what we would now consider to be) an unfair term fulfilled the above requirements it could still be considered fair. Lord Denning therefore resurrected the concept of 'fundamental breach'.⁷⁵¹

In 1977 the Unfair Contract Terms Act (UCTA) came into force which incorporated the Supply of Goods (Implied Terms Act) 1973⁷⁵² and consolidated many of the piecemeal solutions to unfair terms.⁷⁵³ It is argued by the author that UCTA was a

⁷⁴⁷ See Ch. 5.03 Incorporation below; starting with cases such as *Parker v South Eastern Railway Co* [1877] 2 CPD 416 (CA) see particularly Mellish L.J. at 422; *Chapelton v Barry Urban DC* [1940] 1 KB 532 (CA); *Henderson v Stevenson* [1870-75] LR 2 Sc 470 (HL).

⁷⁴⁸ See Ch. 5.02 Interpretation, contra preferentem; *Ernest Beck & Co v K Szymanowski & Co* [1924] AC 43 (HL); *Wallis Son & Wells v Pratt & Haynes* [1911] AC 394 (HL); *Baldry v Marshall* [1925] 1 KB 260 (CA), where the court held the exclusion of a breach of 'guarantee or warranty' did not exclude the breach of a 'condition' (at 158) .

⁷⁴⁹ See Scrutton L.J. in *Gordon Alison & Co v Wallsend Slipway & Engineering Co Ltd* (1927) 27 Ll L Rep 285, at 324.

⁷⁵⁰ This applied in cases where one party would try to exclude liability for their own fraudulent statements (see *S. Pearson & Son Limited v Lord Mayor of Dublin* [1907] AC 351).

⁷⁵¹ *Suisse Atlantique Societe d'Armenent SA v NV Rotterdamsche Koeln Centrale* [1967] 1 AC 361 (HL).

⁷⁵² The 1973 Act provided control over exclusion or restriction clauses for breach of terms implied under the Sale of Goods Act.

⁷⁵³ E.g. Railway and Canal Traffic Act 1854.

product of the post-war consumer protectionist movement.⁷⁵⁴ The application of the reasonableness test unearths a few of the values that influenced the judges over time.

In 1980, in the case of *Photo Production Ltd v Securior Transport Ltd*⁷⁵⁵ the court rejected the principle of fundamental breach on the grounds that commercial parties needed the freedom to apportion the risk between themselves.⁷⁵⁶ In 1993 the EC Council of Ministers adopted the Directive on Unfair Terms in Consumer Contracts⁷⁵⁷ and it was transposed into English Law as the Unfair Terms in Consumer Contracts Regulations 1994 which was then superseded by the Unfair Terms in Consumer Contracts Regulations 1999. The Regulations will not be dealt with in this Chapter as the Unfair Contract Terms Act 1977 provide a clearer view of the underlying values because the Unfair Terms in Consumer Contracts Regulations 1999 were modelled on values outside the UK and this thesis is only concerned with the English values (or German values respectively).

⁷⁵⁴ This does not preclude there being many B2B related provisions included in the Unfair Contract Terms Act 1977.

⁷⁵⁵ *Photo Production Ltd Securior Transport Ltd* [1980] AC 827 (HL), per Lord Wilberforce.

⁷⁵⁶ It could be argued that it was only rejected on the ground that the Lords were aware of the introduction of UCTA and therefore decided not to uphold a competing concept. This discussion will have to be left for another time.

⁷⁵⁷ Council Directive 93/13/EEC of 5 April 1993, OJ L95/29.

5.07 English Law - Interpretation, contra preferentem

The courts in England, as in Germany, have used interpretation to limit the effect of exclusion/unfair clauses in contracts.⁷⁵⁸ The starting point in both jurisdictions was that the clauses were to be given their ordinary meaning and in the 'early days' exclusion clauses in standard form contracts were not interpreted any differently.⁷⁵⁹

By 1924⁷⁶⁰ this approach had changed and exclusion clauses were then interpreted against the party relying on them. If the exclusion clause was not expressed clearly then it would not be effective.⁷⁶¹ The fear seemed to be that interpreting the exclusion clause widely would mean that the party who was already at a disadvantage in terms of bargaining power would be at a further disadvantage.⁷⁶² This works well with the overall theory that the standard term contracts are also

⁷⁵⁸ E.g. in *Ernest Beck & Co v K Szymanowski & Co* [1924] AC 43 (HL): cotton reels of 200 yards each were sold. The contract stated that any defect was deemed to have been accepted if notice was not given after 14 days. The House of Lords held that the clause covered only the right to reject but not the right to claim damages.

⁷⁵⁹ It would seem that this approach can be traced back to the middle of the fifteenth century. In principle, if there was a signed document and there was some form of *quid pro quo* the contract (and thereby the exclusion clause) would be upheld – see Baker, *The Oxford History of the Laws of England Volume VI 1483-1558* (Oxford University Press 2003)p. 814-815.

⁷⁶⁰ *Ernest Beck & Co v K Szymanowski & Co* [1924] AC 43 (HL).

⁷⁶¹ *Ailsa Craig Fishing Co Ltd v Malvern Fishing Co Ltd (The Strathallan)* [1983] 1 WLR 964 (HL); but also see *Bem Dis A Turk Ticaret S/A TR v International Agri Trade Co Ltd (The Selda)* [1999] 1 Lloyd's Rep 729 (CA) or *Air Transworld Ltd v Bombardier Inc* [2012] 1 Lloyd's Rep 349 (CC).

⁷⁶² Coote, *Exception Clauses* (Sweet & Maxwell 1964); p. 15.

meant to inject more certainty into the transaction. In other words it is meant to encourage the drafter of the document to include as much detail as possible particularly in the case where he is excluding his own liability for negligence.⁷⁶³

The development of the *contra preferentem* rule on exclusion/limitation clauses follows a similar pattern to that in Germany. The focus for the courts in the German cases was to what degree the terms deviated from the dispositive law which in turn increased (or decreased respectively) the need for the term to cover the particular event specifically. There is therefore no need for further analysis of the interpretation cases.

5.08 English Law - Incorporation

The incorporation of standard terms into contracts has in some cases provided the courts with the opportunity to exclude unfair terms from contracts. One of the first cases was the 1875 case of *Henderson v Stevenson*.⁷⁶⁴ Lieutenant Stevenson of the 18th Royal Irish Regiment had purchased a ticket to travel from Dublin to Whitehaven. On the back of the ticket the owners of the steamship had excluded all liability and they attempted to rely on this clause when Stevenson's luggage was lost. The court distinguished the case from *Carr v Lancashire and Yorkshire*

⁷⁶³ Note though that the German courts are much less lenient in terms of interpretation in that there has to be genuine ambiguity as to the meaning of the words in order for the term to be excluded (see *BGH NJW 2002, 3232*). It will be shown later that this is mainly due to the use of §§ 138 and 242 BGB.

⁷⁶⁴ *Henderson v Stevenson* [1870-75] LR 2 Sc 470 (HL).

*Railway*⁷⁶⁵ - where the railway company had excluded liability for their own negligence and the court held that the exclusion clause was valid - and held that Stevenson did not have notice of the term on the back of the ticket and therefore the term had not been incorporated into the contract. The court held this to be the case despite this term being displayed at the office.⁷⁶⁶ The basis of the decision was that there was no assent to the terms.⁷⁶⁷ This decision was made despite the earlier judgment of *Zunz v South Eastern Railway Company*⁷⁶⁸ where the court held that where a ticket is taken which contains terms, there is a presumption that the terms have been read.⁷⁶⁹

In *Parker v South Eastern Railway Co.*,⁷⁷⁰ Parker had left his luggage in the cloakroom and received a ticket. The back of the ticket included terms which limited the railway company's liability to £10. Bramwell LJ held that it should be a question of law whether there had been reasonable notice and that therefore he would have found for the defendant. Mellish LJ (with whom the others agreed) argued that it was a matter of whether the person receiving the ticket did or did not see (or at least should have seen) that there was writing on the ticket and whether

⁷⁶⁵ *Carr v Lancashire & Yorkshire Railway* [1852] 7 Ex 707 (CE).

⁷⁶⁶ Here it should be noted that the court did so on the ground that '*no evidence whatever was given that the Pursuer saw, read or indeed had an opportunity of reading that general notice.*'

⁷⁶⁷ See the judgment of *Henderson v Stevenson* [1870-75] LR 2 Sc 470 (HL) per Lord Chelmsford at 476.

⁷⁶⁸ *Zunz v South Eastern Railway Co* [1868-69] LR 4 QB 539 (QB).

⁷⁶⁹ Confirmed later in *Thompson v London Midland & Scottish Railway Co* [1930] 1 KB 41 (CA).

⁷⁷⁰ *Parker v South Eastern Railway Co* [1877] 2 CPD 416 (CA).

he knew (or should have known) that the writing contained conditions. In other words Mellish LJ was looking for whether there had been reasonable notice of the terms.

In *Chapelton v Barry UDC*⁷⁷¹ the plaintiff had borrowed a deck chair (which required him to purchase a ticket). The ticket contained an exclusion clause. The court held that the ticket was only a receipt and that it was not reasonable to expect the ticket to include terms because the reasonable person would expect the ticket to be nothing more than a receipt. It was the element that the customer would not know to look there for the term.

Ch 5.02 discussed the 1928 case⁷⁷² in Germany (and the later analysis), where the court found that the term had not been included because there had been no notice. The German justification for intervention was the protection of the legal system (and the public's faith in the system). The English cases⁷⁷³ were based on the asymmetry of information as between the parties. At this stage the German and English analysis leads to the same end result. The conclusion at this point must therefore be that the English courts focus on whether the procedural fairness has been met (i.e. whether the term was incorporated)⁷⁷⁴ and will not take into account the content of the term on its own.

⁷⁷¹*Henderson v Stevenson* [1870-75] LR 2 Sc 470 (HL).

⁷⁷² RG (25.09.1928) BankA 28/185 .

⁷⁷³ See particularly Mellish LJ above.

⁷⁷⁴ Confirmed by for example *L'Estrange v F. Graucob Limited* [1934] 2 KB 394.

5.09 Fundamental Breach

One of the areas which must be distinguished from the fundamental breach cases are the so-called deviation cases, where there is a deviation from the contractually agreed route. The deviation will be considered breach of a condition of the contract.⁷⁷⁵ An example is *London & North Western Railway v Neilson*,⁷⁷⁶ in which a train unloaded the luggage at the wrong station (where it then went missing). The contract had excluded liability but the court held that because the luggage had been unloaded at the wrong station the exclusion clause could not apply.⁷⁷⁷ The deviation was a breach of a condition in itself, which meant that when the luggage was lost after a breach of that condition the railway company was not entitled to the protection of the exclusion clause.⁷⁷⁸

⁷⁷⁵ *Tate & Lyle Ltd v Hain Steamship Co Ltd* [1963] 2 All ER 597 (HL); but note that there have been alternative explanations: Coote, *Exception Clauses* (Sweet & Maxwell 1964)p. 89-93.

⁷⁷⁶ *London & North Western Railway Co v Neilson* [1922] 2 AC 263 (HL).

⁷⁷⁷ See further examples such as *Bontex Knitting Works Ltd v St. John's Garage* [1944] 1 All ER 381; *Tate & Lyle Ltd v Hain Steamship Co Ltd* [1963] 2 All ER 597 (HL).

⁷⁷⁸ Per Scrutton L.J. in *Gibaud v Great Eastern Railway Co* [1921] 2 KB 426 (CA), at 435: '[...] if you undertake to do a thing in a certain way, or to keep a thing in a certain place, with certain conditions protecting it, and have broken the contract by not doing the thing contracted for in the way contracted for, or not keeping the article in the place in which you have contracted to keep it, you cannot rely on the conditions which were only intended to protect you if you carried out the contract in the way in which you had contracted to do it.'

In the deviation cases breach of the condition would give the aggrieved party a right to terminate the contract.⁷⁷⁹ Interestingly though it would seem that the deviation would also displace any exemption clause,⁷⁸⁰ whether or not the other party accepts the deviation or not.⁷⁸¹ The deviation cases are important though to the fundamental breach cases because the House of Lords, in *Hain v Tate & Lyle* used the term fundamental to delineate between 'normal' conditions and such which are 'fundamental'.⁷⁸² In *Tate & Lyle v Hain*⁷⁸³ it was held that in a contract for the carriage of goods by sea there was an implied condition that they would follow the agreed route. The breach of such a condition will give the other party the right to rescind the contract (or alternatively waive that right).

⁷⁷⁹ This right may be lost by waiver – see *Tate & Lyle Ltd v Hain Steamship Co Ltd* [1963] 2 All ER 597 (HL).

⁷⁸⁰ Unless the ship-owner can prove that the damage would have occurred despite the deviation (see Coote, *Exception Clauses* (Sweet & Maxwell 1964) p. 88 for an explanation) – and in some cases the contract would continue without the exclusion clauses applying.

⁷⁸¹ See *ibid* p. 81; *Davis v Garrett* [1830] 6 Bing 716 (CP); *Scaramanga & Co v Stamp* [1880] 5 CPD 295 (CA).

⁷⁸² This is because of Lord Atkin and Lord Wright's use of the word 'fundamental' see B. Coote, *Exception Clauses* (Sweet & Maxwell 1964); p. 104-105.

⁷⁸³ *Tate & Lyle Ltd v Hain Steamship Co Ltd* [1963] 2 All ER 597 (HL).

From this same line of thought Devlin J.⁷⁸⁴ in *Smeaton Hanscombe & Co. Ltd v Sassoon 1. Setty & Co. (No. 1)*⁷⁸⁵ laid down the definition of 'fundamental term':

*I do not think that what is a fundamental term has ever been closely defined. It must be something, I think, narrower than a condition of the contract, for it would be limiting the exception too much to say that they applied only to breaches of warranty. It is, I think, something which underlies the whole contract so that, if it is not complied with, the performance becomes something totally different from that which the contract contemplates.*⁷⁸⁶

The judgment provided more than just an explanation of what a fundamental term was. It also provided an explanation of what Devlin J. was attempting to protect, namely the reasonable expectations of the business parties. In effect he seems to be saying that if the term ultimately destroys the reason for contracting then it is absurd to think that anyone would have agreed to it under the circumstances.⁷⁸⁷

⁷⁸⁴ See also previous cases such as *Atlantic Shipping Co v Dreyfus* [1922] 1 AC 250 (HL); *Chandris v Isbrandtsen Moller Co Inc* [1951] 1 KB 240 (CA); *Alexander v Railway Executive* [1951] 2 KB 882 (KB).

⁷⁸⁵ *Smeaton Hanscomb & Co v Sassoon 1 Setty Son & Co (No. 1)* [1953] 1 WLR 1468 (QB).

⁷⁸⁶ *Ibid.* at 1470.

⁷⁸⁷ See Pearson L. J. *UGS Finance v National Mortgage Bank of Greece and National Bank of Greek SA* [1964] 1 Lloyd's Rep 446 (CA), 450: '...[I]t is a rule of construction based on the presumed intention of the contracting parties...' (Affirmed in *Suisse Atlantique Societe d'Armenent SA v NV Rotterdamsche Koeln Centrale* [1967] 1 AC 361 (HL).

The concept of 'breach of a fundamental term' came at a time⁷⁸⁸ when there was general discomfort with the previous '*laissez-faire*' approach⁷⁸⁹ to exclusion clauses, and was welcomed⁷⁹⁰ with open arms.⁷⁹¹ Three years later Denning L.J. attempted a further definition of a fundamental breach: '*If he has been guilty of a breach of those obligations in a respect which goes to the very root of the contract, he cannot rely on the exempting clauses.*'⁷⁹² This is the first attempt to review the content of an exclusion clause as opposed to the review of the procedural aspect of the exclusion clause.⁷⁹³

⁷⁸⁸ Even though it was by no means a new concept – see Melville, 'The Core of a Contract' (1956) 19 *The Modern Law Review*; at p. 26

⁷⁸⁹ The term '*laissez-faire*' is used only in the context unfair contract term and does not relate to the contested overarching term that was used to describe contract law during the industrialist society. (see MacMillan, 'Contract Terms between unequal parties in victorian England' in Louise Gullifer and Stefan Vogenauer (eds), *English and European Perspectives on Contract an Commercial Law - Essay in Honour of Hugh Beale* (Hart Publishing 2015), p. 15 – 17.

⁷⁹⁰ Note thought that Pearson L.J. rejected that fundamental breach constituted a rule of *UGS Finance v National Mortgage Bank of Greece and National Bank of Greek SA* [1964] 1 Lloyd's Rep 446 (CA), 450.

⁷⁹¹ See Coote, *Exception Clauses* (Sweet & Maxwell 1964); p. 108.

⁷⁹² *Karsales (Harrow) Ltd v Wallis* [1956] 1 WLR 936 (CA).

⁷⁹³ i.e. does the clause cover the breach, is it incorporated etc.

The first doubts were raised by Lord Reid⁷⁹⁴ in *Suisse Atlantique*⁷⁹⁵ where he mentions that it is difficult to assess whether an exclusion clause can always be considered ‘*harsh and unfair*’ in different circumstances. The problem that Lord Reid identified was that of a consumer who has no choice but to accept the contract and who may therefore be disadvantaged by the breach of a fundamental term and two commercial parties who may want to deliberately distribute the risk (for example due to insurance) in that particular way. Lord Reid also called for legislative intervention on the matter on the basis that stretching the existing principles could not provide a satisfactory answer.⁷⁹⁶ The court concluded⁷⁹⁷ – similar to the German court’s approach - that an adaptation of the *contra preferentem* rule should be applied, in that the more serious the breach in the particular instance the less likely it would be that there was intention to exclude or limit liability.

⁷⁹⁴ Even though the case did intimate that the court would have held that there had been a fundamental breach.

⁷⁹⁵ *Suisse Atlantique Societe d'Armenent SA v NV Rotterdamsche Koeln Centrale* [1967] 1 AC 361 (HL)

⁷⁹⁶ ‘Courts have often introduced new rules when, in their view, they were required by public policy. In former times when Parliament seldom amended the common law, that could hardly have been avoided. [...] But my main reason is that this rule would not be a satisfactory solution of the problem [...]’, *ibid.* at p. 406.

⁷⁹⁷ Thereby rejecting Denning L.J.’s attempt of the substantive doctrine of fundamental breach in *Karsales (Harrow) Ltd v Wallis* [1956] 1 WLR 936 (CA).

The difficulty of examining the content of the exclusion clause rather than the procedural aspects re-appeared in *Photo Production Ltd v Securior Transport Ltd*,⁷⁹⁸ where the employee of the security company, employed to guard the premises, lit a fire which burnt them down. The term in the contract provided that Securior would only be liable for the actions of their employees where they had been negligent in their selection. The court held that due to the nature of the companies this term was in fact fair. This ruling brought the concept of fundamental breach to an end.⁷⁹⁹

The German courts never attempted any such approach to exclusion/limitation clauses. Lord Reid's fear of the individual consumer without a choice was most likely what motivated the German courts to use §138 BGB by identifying that this would only be the case where there was a monopoly – although this would not be the case where all the competitors are using the same standard terms. The protection of society against the monopoly does not seem to feature at all in the English cases on fundamental breach neither does the need to protect society against these terms.⁸⁰⁰ In fact the main concern in the English cases seems to be the protection of the reasonable expectations.

⁷⁹⁸ Railway and Canal Act 1854.

⁷⁹⁹ Ignoring Denning MR's attempt in the Court of Appeal to follow his judgment in *Harbutt's Plasticine Ltd v Wayne Tank & Pump Co Ltd* [1970] 1 QB 447 (CA).

⁸⁰⁰ With the exception of *A Schroeder Music Publishing Co Ltd v Macaulay (Formaly Instone)* [1974] 1 WLR 1308 (HL) where the emphasis was on protecting the individual from the monopoly. However, there seems to be no evidence of any later judgments referring to the monopoly status of the other party as a ground for review the standard terms.

5.10 UCTA 1977 and the Reasonableness Test

For the first time in 1975 the public interest as a whole was acknowledged as a motivator by the Law Commission.⁸⁰¹ The Law Commission identified in their work that certain terms are to be considered 'unfair' simply for their impact on society.⁸⁰² The report also mentions the difficulty of a monopoly (or virtual monopoly).⁸⁰³ However, and again unlike Germany, the monopoly does not feature in the legislation either. This is an indication that the legislator in England is aware of the fact that a monopoly could lead to unfair terms being imposed but that there is a belief that it is not the cause or origin of unfair terms – for example a whole industry may be using the same unfair terms.

A further concern for the Commission was the reasonableness test which was to be applied mainly in non-consumer cases.⁸⁰⁴ The Law Commission was clear on the need to protect the individual consumer and that this will, in contrast to the non-

⁸⁰¹ See the Second Law Commission Report No. 69 (and Scottish Law Commission Report No.

39)(1975); p.4 – *We are in no doubt that in many cases they operate against public interest and that the prevailing judicial attitude of suspicion, or indeed of hostility, to such clauses is well founded.*

⁸⁰² See for example the need for control on clauses exempting from liability for negligence: [...] *are in many cases a serious social evil*[...] (Law Commission Report No. 69 (1975) p. 19.

⁸⁰³ the Second Law Commission Report No. 69 (and Scottish Law Commission Report No. 39)(1975); p.36.

⁸⁰⁴ Applied by the courts in cases such as *London & North Western Railway Co v Neilson* [1922] 1 KB 192 (CA) and *Chapelton v Barry Urban DC* [1940] 1 KB 532 (CA).

consumer cases, mean an outright ban in order to provide certainty to the consumer.⁸⁰⁵

Despite the name suggesting that the act deals with unfair clauses generally, it in fact only deals with exclusion (and limitation) clauses.⁸⁰⁶ The scope of the act is wide enough to cover the cases where there is an attempt to indirectly exclude or limit the remedies that the other party would usually have at his disposal.⁸⁰⁷ There are two main distinctions within the Act. The first is whether the other party deals as a consumer or whether they are dealing in the course of a business (this will be addressed below).⁸⁰⁸ The second (and this is often linked to the first) is whether the clause is outright void or whether it is subject to the reasonableness test. It is impossible to exclude liability for negligence which leads to death or personal injury.⁸⁰⁹ If the other party is acting in the course of a business then a clause excluding negligence giving rise to loss or damage (other than death or personal injury) is subject to the reasonableness test.

⁸⁰⁵ See First Report on Exemption Clauses in Contracts (No. 24) Law Commission (1969), at 73.

⁸⁰⁶ With the exception of S. 3 (2) (b) (i) and (ii), s. 4 UCTA 1977.

⁸⁰⁷ See the definition in s. 13 UCTA 1977.

⁸⁰⁸ Note that a business may also be seen as a consumer (*R&R Customs Broker Co Ltd v United Dominions Trust Ltd* [1988] 1 All ER 847 (CA)) or dealing on the others standard terms (see the definition of 'standard terms' in *St Albans City and DC v International Computers Ltd* [1996] 4 All ER 481 (CA)).

⁸⁰⁹ S. 2(1) UCTA 1977.

There are three tests of reasonableness in UCTA. The first is a general test (which can only apply in conjunction with the relevant provisions),⁸¹⁰ the second only applies to clauses which limit the amount of compensation that can be recovered,⁸¹¹ the third only applies to clauses which are caught by ss 6(3) (excluding terms implied by the Sale of Goods Act⁸¹² in sale and hire purchase agreements when not acting as a consumer) and 7(3) (excluding terms implied by the Sale of Goods Act⁸¹³ in agreements where possession or ownership passes but is not governed by the law of sales of goods or hire purchase when not acting as a consumer).

The reasonableness test in UCTA is an example of a legal concept with variations on the normative meaning depending on the scenario to which it is applied. The normative meaning relies on the values that the judges (or decision-makers generally) believe should be⁸¹⁴ driving the legal concept. It is acknowledged that the idea to implement UCTA was driven by post-war consumer protection policies.⁸¹⁵ That same drive was countered by the desire for a non-interventionist approach to commercial contracts – though this will be qualified below. The reasonableness in

⁸¹⁰ S. 11 (1), (3) and (5) UCTA.

⁸¹¹ S. 11 (4) UCTA.

⁸¹² S. 13, 14 or 15 SGA.

⁸¹³ S. 13, 14 or 15 SGA.

⁸¹⁴ Whether consciously or unconsciously.

⁸¹⁵ Brownsword and Adams, 'The Unfair Contract Terms Act: A Decade of Discretion' (1988) 94 Law Quarterly Review, at FN 2; See also the introduction to of the '*Final Report of the Committee on Consumer Protection*' (July 1962).

UCTA is supported by a list in Schedule 2 of the Act of what should be taken into account in the assessment of terms:⁸¹⁶

- (a) The bargaining positions of the parties relative to each other, taking into account (among other things) alternative means by which the customer's requirements could have been met;*
- (b) Whether the customer received an inducement to agree to the term, or in accepting it had an opportunity of entering into a similar contract with other persons, but without having a similar term;*
- (c) Whether the customer knew or ought reasonably to have known of the existence and the extent of the term (having regard, among other things, to any custom of the trade and any previous course of dealing between the parties);*
- (d) Where the term excludes or restricts any relevant liability if some condition was not complied with, whether it was reasonable at the time of the contract to expect that compliance with that condition would be practicable;*
- (e) Whether the goods were manufactured, processed or adapted to the special order of the customer.*

The assessment of this list will show that the underlying values in the English system are the protection of the information symmetry and bargaining power between the parties as opposed to the German values of protection of the legal system and protection of society as whole.

⁸¹⁶ Even though the guidelines are expressly for s. 6 and 7 of UCTA they are regarded as generally applicable (*Stewart Gill Ltd v Horatio Myer and Co Ltd* [1992] QB 600 (CA), at 608; *Singer Co (UK) Ltd v Tees and Hartlepool Port Authority* [1988] 2 Lloyd's Rep 164 (CC) at 169).

5.11 UCTA and Unequal bargaining power

Both in the German courts and the English courts it is apparent that the bargaining position of the parties is relevant. The approach to evaluating the difference in bargaining positions in Germany is the test of whether there is a monopoly. The initial approach therefore relies in the fact that if there is no monopoly then the parties have the option of alternative sources which in turn alleviates the need for the courts' intervention. The English approach to monopoly is, as shown above, almost non-existent but the inequality of bargaining power appears as an important factor in Lord Wilberforce's reasoning in *Photo Production*:⁸¹⁷

'After this Act, in commercial matters generally, when the parties are not of unequal bargaining power and when risks are normally borne by insurance, not only is the case of judicial intervention undemonstrated, but there is everything to be said, and this seems to have been Parliament's intention, for leaving the parties free to apportion risks as they think fit and for respecting their decisions.'

Lord Wilberforce's reasoning paints a clear picture of what he believes the court's approach to commercial contracts and clauses therein should be, namely non-interventionist. There is the argument that this was later reduced in *George Mitchell*⁸¹⁸ where the courts took a further aspect into consideration. The decision that the limitation clause was unreasonable was based on the conduct of the seeds men in often settling claims that exceeded the limit of the clause. The court held

⁸¹⁷ *Photo Production Ltd Securior Transport Ltd* [1980] AC 827 (HL), at 843.

⁸¹⁸ *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd* [1983] 2 AC 803 (HL).

that this was an acknowledgement that the clause was unreasonable. Custom within the particular area of business would seem to influence the judges' decision.

The non-interventionist approach when the parties are of equal bargaining power was seen again in *Watford Electronics Ltd. v Sanderson CFL Ltd.*⁸¹⁹

'Where experienced businessmen representing substantial companies of equal bargaining power negotiated an agreement, they may be taken to have had regard to the matters known to them. They should, in my view, be taken to be the best judges of the commercial fairness of the agreement which they have made; including the fairness of each of the terms of that agreement.'

The equality of bargaining power is mainly added in cases where the courts are upholding the exclusion/limitation clause⁸²⁰ as an added confirmation. In *West v Ivan Finlay & Associates*⁸²¹ the main argument seemed to be whether or not Wests had understood (or at least were able to understand) the clause when they entered into the contract. The fact that the clause (which the court did acknowledge caused

⁸¹⁹ *Watford Electronics Ltd v Sanderson CFL Ltd* [2001] EWCA Civ 317 (CA), [55].

⁸²⁰ *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd* [1983] 2 AC 803 (HL); *Singer Co (UK) Ltd v Tees and Hartlepool Port Authority* [1988] 2 Lloyd's Rep 164 (CC); *Watford Electronics Ltd v Sanderson CFL Ltd* [2001] EWCA Civ 317 (CA); *AXA Sun Life Services Plc v Campbell Martin Ltd* [2011] EWCA Civ 133 (CA); *West v Ian Finlay and Associates* [2014] EWCA Civ 316 (CA); *Marex Financial Ltd v Creative Finance Ltd* [2013] EWHC 2155 (Comm) (CC).

⁸²¹ *West v Ian Finlay and Associates* [2014] EWCA Civ 316 (CA), at [58] and [60].

an imbalance in the parties' rights) was prominently displayed was the deciding factor.⁸²²

However, there is no evidence to suggest that a term has been held invalid due to the unequal bargaining positions of the parties alone.⁸²³ This suggests that the court's main interest is not the bargaining power of the parties but, as in *West v Ivan Finlay & Associates*,⁸²⁴ whether the other party knew or ought to have known of the term in the individual circumstances.

5.12 UCTA and Consent

In *Stag Line Ltd v Tyne Ship repair Group Ltd (The Zinnia)*⁸²⁵ Staughton J examined an exclusion clause for any economic loss and a clause that limited all the remedies unless the vessel was returned to the yard. His main argument was that the print was so small and the language so complicated that they should be held unfair and

⁸²² Ibid. at [67].

⁸²³ See *George Mitchell (Chesterhall) Ltd v Finney Lock Seeds Ltd* [1983] 2 AC 803 (HL); *Singer Co (UK) Ltd v Tees and Hartlepool Port Authority* [1988] 2 Lloyd's Rep 164 (CC); *Watford Electronics Ltd v Sanderson CFL Ltd* [2001] EWCA Civ 317 (CA) *AXA Sun Life Services Plc v Campbell Martin Ltd* [2011] EWCA Civ 133 (CA); *West v Ian Finlay and Associates* [2014] EWCA Civ 316 (CA); *Marex Financial Ltd v Creative Finance Ltd* [2013] EWHC 2155 (Comm) (CC) which all deal with equal bargaining power.

⁸²⁴ *West v Ian Finlay and Associates* [2014] EWCA Civ 316 (CA) at [58] and [60].

⁸²⁵ *Stag Line Ltd v Tyne Ship Repair Group Ltd (The Zinnia)* [1984] 2 Lloyd's Rep 211 (CC).

unreasonable;⁸²⁶ the case was decided on other grounds.⁸²⁷ It would seem that Staughton J was guided by the consent factor – i.e. it was unreasonable to assume that the parties had understood the contract. This approach is later confirmed in *Rees-Hough*⁸²⁸ where the standard terms excluded liability for pipes that broke due to pressure. It was held that the term was reasonable on the basis that the parties were of equal bargaining power, the term was intelligible and no objection had been raised.

In Ch. 5.11 it was argued that the main consideration for the English courts is whether in fact the term was known (or ought to have been known) and understood by the other party. The importance of consent was also stressed by the Scottish Law Commission when they stated that *'it must be clear or at least determinable from the outset what each contracting party has agreed to do or to give or abstain from doing [...]'*⁸²⁹ The idea of custom resurfaces in *AEG (UK) Ltd v Logic Resource Ltd*.⁸³⁰ The contract was for goods that were to be shipped to Iran. The goods were faulty and the defendant returned the goods to AEG and

⁸²⁶ *'First, they are in such small print that one can barely read them; secondly, the draughtsmanship is so convoluted and prolix that one almost needs an LL.B. to understand them. However, neither of those arguments was advanced before me, so I say no more about them.'* (*ibid.* at 222).

⁸²⁷ *Ibid.* at p. 222.

⁸²⁸ *Rees Hough Ltd v Redland Reinforced Plastics Ltd* (1984) 27 BLR 136.

⁸²⁹ For a more detail see Nebbia, *Unfair Contract Terms in European Law: A Study in Comparative and EC Law* (Hart Publishing 2007), p.67.

⁸³⁰ *AEG (UK) LTD v Logic Resource Ltd* [1996] CLC 265.

deducted the cost of transport from the bill. AEG then brought a claim for the difference due to a clause in the contract that the purchaser shall return the defective parts at his own expense. The terms had been incorporated into the contract by reference which could be requested from AEG. The court had to then decide whether Sched. 2 (c) in UCTA applied (*whether the customer knew or ought reasonably to have known of the existence and extent of the term (having regard to, among other things, any custom of the trade and any previous course of dealing between the parties)*). It would seem that in this case the courts went as far as to invoke a reasonableness at common law rather than statutory reasonableness test.⁸³¹ The important factor was though that the courts considered that the term was unreasonable. It is not unusual for standard form contracts to replace the statutory warranties with express shorter warranties (in commercial contracts). Therefore it could not really be argued that the term was particularly unusual in comparison to the industry norm. However, the fact that the term was in such small print, almost intelligible and only available upon request persuaded the court that the term was unreasonable and (with Lord Hobhouse dissenting) that it had not been incorporated. Lords Hirst and Hobhouse seemed to qualify the objective approach to incorporation and introduced the consideration of whether the consent was 'real'.⁸³² The case is particularly striking because the courts decided to invoke the common law approach of incorporation in order to hold that the term

⁸³¹ For further discussion on this topic see Bradgate, 'Unreasonable Standard Terms' (1997) 60 MLR 586, p. 582 – 593.

⁸³² See Hirst LJ at 274 and Hobhouse LJ at 278 in *AEG (UK) LTD v Logic Resource Ltd* [1996] CLC 265.

did not apply and this was done solely on the basis that the term should have been brought to the attention of the other party.⁸³³ In *Phillips Products Ltd v Hyland*⁸³⁴ the court held that a term in the contract was unreasonable due (partly) to the fact that the other party had little time to review the contract.⁸³⁵ In *Singer co (UK) Ltd v Tees and Hartlepool Port Authority*⁸³⁶ the court held that a term excluding liability for damage other than from proven negligence (in which case liability was limited) was reasonable on the basis that they could have opted to pay a higher fee for more control over the loading process. The court's approach would seem to boil down to whether there was in fact consent and in this case it was clear that through the option of paying a higher price the other party must have been aware of the limitation on liability and in fact opted for that limitation.⁸³⁷

5.13 Risk Allocation

Risk allocation in commercial contracts is a factor that influences the parties' decisions and calculations. The courts, in both Germany and England, take the allocation of risk in commercial contracts as part and parcel of everyday dealing. It is not therefore surprising that the reasonableness of the relative allocation of risk

⁸³³ Bradgate, 'Unreasonable Standard Terms' (1997) 60 MLR 586.

⁸³⁴ *Phillips Products v Hyland* [1987] 1 WLR 659 (CA).

⁸³⁵ See Ch. 5.13 below for a case where there was sufficient time and the term was held to be reasonable.

⁸³⁶ *Singer Co (UK) Ltd v Tees and Hartlepool Port Authority* [1988] 2 Lloyd's Rep 164 (CC).

⁸³⁷ See also *Sonicare International Ltd v East Anglia Freight Terminal Ltd* [1997] 2 Lloyd's Rep 48 (CC); *Monarch Airlines Ltd v London Luton Airport Ltd* [1998] 1 Lloyd's Rep 403 (CC), where the court held that the parties knew of the term and could make the appropriate insurance arrangements.

features in judges' decisions. However, it would also seem that when the judgment is based on the allocation of risk between the parties it is in fact a question of consent. In *Arthur White v Tarmac*⁸³⁸ the court held that the exclusion clauses were in fact only a distribution of risk (i.e. a setting out of obligations), i.e. it only defined the parties' obligations and divided the risk of the JCB driver's actions between themselves. Particularly important was the fact that the division allowed for the parties to take out the relevant insurance cover. However, *Phillips Products Ltd v Hyland*⁸³⁹ it was held that a similar clause in a similar contract was unreasonable due to the short notice that was given and the resulting lack of time to review the contract.⁸⁴⁰ This point can be taken further in that in short notice contracts, where it is unlikely that the parties will read all the terms (and of course unlikely that they will take out the relevant insurance cover), it can be presumed that the party did not consent to the terms.

In *Britvic v Messer*⁸⁴¹ the contract was for the supply of carbon dioxide according to BS 4105. In short, the drink contained uncontrolled amounts of benzene and therefore did not comply with BS 4105. This could only occur through a fault in the manufacturing process. Messer had excluded liability and the court held that this was unreasonable.⁸⁴² The reasoning was particularly interesting namely that

⁸³⁸ *Arthur White (Contractors) Ltd v Tarmac Civil Engineering Ltd* [1967] 1 WLR 1508 (HL).

⁸³⁹ *Phillips Products v Hyland* [1987] 1 WLR 659 (CA).

⁸⁴⁰ Note also that the court held that this case was decided on the particular facts of the case.

⁸⁴¹ *Britvic Soft Drinks Ltd v Messer UK Ltd* [2002] EWCA Civ 548.

⁸⁴² Although the case failed on other grounds.

because the fault could only arise in the manufacturing process Britvic could not be expected to test the supplied substance and Messer would have been able to pass the claim on to the actual manufacturer of the product. The court thereby took the allocation of risk in these circumstances and to a certain extent the insurance,⁸⁴³ presuming here that the manufacturer was insured, into account in assessing the reasonableness of the term. *Britvic v Messer*⁸⁴⁴ is one of the few cases where the courts have taken into account the substance of the term rather than the procedure⁸⁴⁵, which may indicate a shift in values.

5.14 Conclusion

There has been some shift in recent years with the advance of economic thinking in European Civil Law.⁸⁴⁶ The economic analysis of unfair contract terms in standard form contracts leads to the conclusion that it is not necessarily the bargaining power of the other party that results in accepting the pre-formulated contract but the higher costs in having the contract reviewed by a legally qualified person and

⁸⁴³ *Britvic Soft Drinks Ltd v Messer UK Ltd* [2002] EWCA Civ 548, at [26].

⁸⁴⁴ Note though that the limitation clause in that case was upheld.

⁸⁴⁵ See also *Bacardi Martini Beverages Ltd v Thomas Hardy Packaging Ltd* [2002] EWCA Civ 549 (CA); however the fact that it was decided under UCTA makes the case slightly less surprising because it allows the court to evaluate the substance of the term.

⁸⁴⁶ Becher, 'Asymmetric Information in Consumer Contracts: The Challenge that is yet to be met' (2008) 45 ABLJ.

the fact that the events for which the clause is designed⁸⁴⁷ are in fact unlikely⁸⁴⁸ to occur.⁸⁴⁹ Ch. 5.11 and Ch. 5.12 both proved that the main concern for the English courts is whether the other party knew or ought to have known of the clause. These are mainly cases where the court is considering whether the procedure of how the agreement was entered into were reasonable. It is interesting though that the English courts have focused on whether or not there is individual consent in the particular cases. The underlying values seem to lead back to 'reasonable expectations'.

The German approach has used the argument of limiting the individual's autonomy in order to justify intervention in the case but it would seem that the individual assessment of the terms is based on broader principles. The protection of society as a whole which gathered momentum during the nationalist socialist era and seems to have carried through until this day. This value is later combined with the protection of the legal system, i.e. there is a need to protect society against an

⁸⁴⁷ i.e. default or liability for defects.

⁸⁴⁸ Note that in addition to this it has been argued that the other person may not be aware of the full extent of the risks involved which in turn means that they underestimate the risks involved. Leyens and Schaefer, 'Judicial Control of Standard Terms and European Private Law' in P Larouche and Filomena Chirico (eds), *Economic Analysis of the DCFR* (Sellier European Law Publishers 2010), 97, at p. 99.

⁸⁴⁹ Drygala, 'Unfair Contract Terms in Business to Business Transactions' in B Heiderhoff T Drygala, M Staake, G Zmij (ed), *Private Autonomy in Germany and Poland and in the Common European Sales Law* (De Gruyter 2012), p. 42.

alternative legal order that is contrary to the principles of the BGB and there is the need to protect society against monopolistic behaviour.

The English approach is focussed in the first instance on consumer protection on the one hand and protection of the reasonable expectations of business people (represented by the need for consent or implied consent) on the other. There is no indication of any value in terms of the protection of society or societal norms as in the German cases.

The final point in this chapter that stands out is what the courts (and legislators) have focused on in order to assess what is 'unfair'. It is a fair summary that the English courts have focussed on the how serious the breach is that the term is aiming to protect. There is no such assessment in German law but instead the analysis is based on how far the term deviates from the norms of the BGB. The value that seems to be protected in the English cases is therefore the freedom of contract of the individual parties (which is then limited in line with the policies mentioned above) but in the German cases reveal that protection of the BGB is the main value that is being protected.

Chapter 6 – Change of Circumstances

6.01 Introduction

This chapter will take a closer look at the values underlying the law of frustration. In both the German and English legal system the approach to 'simple' frustration cases - where it has become impossible or illegal to perform the contract - is largely

the same⁸⁵⁰ and, apart from outlining the basic approach, this chapter will ignore these pure cases. It is the cases that are on the periphery that are of interest here because these are the cases where the courts have been willing to stretch the existing legal principles in order to do (what they perceive as) justice. From that, the underlying values can then be deduced. The starting point in both jurisdictions will always be freedom of contract: if the parties had clearly foreseen the event then the courts will uphold that agreement.⁸⁵¹ Much more interesting here is when, how, and why the courts are willing to impinge on the parties' freedom. In the German section it will be shown that the courts will attempt to uphold the contractual agreement but to adjust the contract to the changed circumstances. In the English cases if they are stretching the meaning of 'impossible' to include cases that are technically impracticable but not impossible then the court will hold that the contract is discharged. However, there are some cases where the English courts have left the doctrine of frustration aside and have used construction in order to adjust the contract.

In terms of the values at play it should be said that firstly there seems to be a different understanding, further proof of the thesis in chapter 5,⁸⁵² in Germany of the 'autonomy of the parties' than there is in England and similarly that what is seen as 'protecting the economy' in Germany is seen in England in quite the

⁸⁵⁰ In the UK this has been the case since the introduction of the Law Reform (frustrated Contract Act 1943, s. 1(2).

⁸⁵¹ With the exception of 'illegality' which will not be discussed here.

⁸⁵² See Ch. 5.14.

opposite light. The difference in understanding will mean that the chapter will first draw out that difference⁸⁵³ and only then begin to explain the underlying values of those principles.⁸⁵⁴

6.02 German Law - Impossibility and change of circumstances

The first principle to recall is that generally each party has a right to specific performance,⁸⁵⁵ unless the other party is released from this duty through a provision in the BGB.⁸⁵⁶ The second principle to bear in mind is the division between the creditor's and the debtor's duties, which exist independently from each other.

Keeping the above principles in mind, § 275 BGB gives the party that cannot perform their side of the bargain due to impossibility (or, as will be shown shortly, impracticability) the right to refuse performance. This right is now (it was different before the reform of 2002)⁸⁵⁷ regardless of fault and regardless of whether it is only impossible for that party or impossible for anyone. It is also irrelevant at this stage

⁸⁵³ See Ch. 6.02 -6.05.

⁸⁵⁴ See Ch. 6.06.

⁸⁵⁵ See § 241 BGB that states: *'(1) By virtue of the obligation relationship, the creditor is entitled to demand performance from the debtor. Performance can also consist in an omission. (2) The obligation relationship can, according to its content, oblige each party to have regard to the rights, legal entitlements and interests of the other party.'* See also § 883 ZPO.

⁸⁵⁶ See Ch. 6.05 for examples.

⁸⁵⁷ The old § 275 (1) BGB read: *'Der Schuldner wird von der Verpflichtung zur Leistung frei, soweit die Leistung infolge eines nach der Entstehung des Schuldverhältnisses eintretenden Umstandes, den er nicht zu vertreten hat [emphasis added], unmöglich wird.'*

whether or not it was impossible from the outset or became impossible after the contract had been made. § 275 BGB states that:

(1) A claim for performance is excluded to the extent that performance is impossible for the obligor or for any other person.

It is important to recall that it is not that the party does not have to perform at all and is therefore released from all his obligations under the contract, it only releases the obligor from his duty to specifically perform the contract. In cases where the obligor deliberately caused the impossibility he will have to pay compensation according to § 283 BGB (and then § 280 BGB and § 281 BGB). If he caused the impossibility negligently, the BGB equates it with cases where it was caused deliberately.⁸⁵⁸ There is an exception to this, namely if the parties have stipulated that the risk may fall to the obligee. In the case where the ring is to be transported to the other side of the lake and is for that reason thrown across the lake, the parties may have stipulated in the contract that the risk (of the ring not getting to the other side of the lake) for this action shall lie with the obligee. However, it is not possible to exclude liability for deliberate actions.⁸⁵⁹

In cases where the impossibility was not the obligor's fault § 280 (1) BGB will not apply and the obligee will not be able to claim damages. This does not preclude the obligee from terminating the contract through § 323 BGB and therefore not

⁸⁵⁸ See §276 (1) and (2) BGB.

⁸⁵⁹ §276 (3) BGB.

providing his side of the bargain.⁸⁶⁰ There is an exception to this if the obligee (rather than the obligor) is responsible or is mostly responsible for the impossibility.⁸⁶¹ In such a case the obligee will not be able to withhold his performance but the obligor will be excused from performing.⁸⁶² It is then the obligor's responsibility to prove that he was not at fault in order to avoid having to pay damages in lieu of performance.⁸⁶³ However, impossibility does not cover cases where it has become more burdensome to fulfil the obligations under the contract. These cases are covered by § 313 BGB.⁸⁶⁴

6.03 German Law – the History

§ 313 BGB was introduced into the BGB with the reform of the law of obligations in 2002,⁸⁶⁵ which meant that the first draft of the BGB did not include any provision dealing with cases where the circumstances had changed but did not make it impossible to perform the contract. The idea that something may have disturbed the foundation of the transaction has its roots in the Roman law. The principle of

⁸⁶⁰ Although he may want to continue the contractual arrangement in cases where there is partial impossibility which will be discussed later.

⁸⁶¹ § 326 (2) BGB.

⁸⁶² § 275 (1) – (3) BGB.

⁸⁶³ It is the negative wording in §280 BGB that shows - *'this does not apply if the debtor is not responsible for the breach of his duties'* (emphasis added) - that there is a general presumption that the debtor is responsible for any breach of his duties and that therefore the burden is on the obligor to prove he was not at fault.

⁸⁶⁴ Though there may still be instances where this kind of case could be covered by § 275 (2) BGB.

⁸⁶⁵ See Ch. 2.01.

clausula rebus sic stantibus (literally translated: ‘things thus standing’) is based on the premise that the circumstances surrounding the contract will stay the same. In other words there is an implied condition that the foundational assumptions upon which the contract rest will remain the same. There is some evidence to suggest that Cicero⁸⁶⁶ used this idea in 44 A.D., his examples include a sword that would not have to be returned to the owner after he has become insane.⁸⁶⁷ Thomas von Aquin, in *Summa Theological*, applied the principle of clausula (though he did not use that word) in the context of changed circumstances in light of wars,⁸⁶⁸ although he did not confine its use to contracts.⁸⁶⁹ It is not until the 16th century that the ‘clausula’ becomes a general principle that underlies all legal acts as a ‘tacita conditio’.⁸⁷⁰ The 17th Century saw a rise in use of the clausula doctrine both in private and public international law.⁸⁷¹ A general clausula principle was added to the Codex Maximilianeus Bavaricus Civilis⁸⁷² but it was again limited to the law of

⁸⁶⁶ Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (Clarendon Press 1996), p. 579.

⁸⁶⁷ Koebler, *Die Clausula rebus sic stantibus als allgemeiner Rechtsgrundsatz* (Mohr Paul Siebeck Tuebingen 1991), p. 23.

⁸⁶⁸ Ibid. p. 29.

⁸⁶⁹ Huang, *Zur Lehre von der Geschäftsgrundlage nach altem und neuem Recht* (Peter Lang Verlag 2008); p. 19.

⁸⁷⁰ Koebler, *Die Clausula rebus sic stantibus als allgemeiner Rechtsgrundsatz* (Mohr Paul Siebeck Tuebingen 1991), p. 30.

⁸⁷¹ Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (Clarendon Press 1996), p. 581.

⁸⁷² See §12 IV, 15 Codex Maximilianeus Bavaricus Civilis.

obligations and then limited by the principle of fault – i.e. if the change in circumstances had been caused by the obligor's fault, he could not rely on the principle. It also allowed the judge a great deal of discretion in the choice of remedy (i.e. whether all obligations under the contract are to be reversed or only some is at the judge's discretion).⁸⁷³ The *clausula* next appeared in the ALR⁸⁷⁴ (the Prussian civil code) in § 377, I, 5 ALR and § 378, I, 5 ALR 1794. However, the principle was severely restricted so that it only really applied to cases of impossibility.⁸⁷⁵ In the Code Civil of 1804,⁸⁷⁶ by contrast, the *clausula* were completely excluded, which is not surprising as in the 19th century, with the rise of Savigny's will theory (and his predecessors),⁸⁷⁷ the discussion of codification⁸⁷⁸ and the search for legal reason

⁸⁷³ Ibid.: *„ob die Obligation völlig aufgehoben, oder nur nach Proportion der Veränderung gemäß werden solle“*.

⁸⁷⁴ See also § 267, 268, II 2 of the draft to the ALR where the principle had a slightly wider scope.

⁸⁷⁵ Pfaff, 'Die Clausel: Rebus sic stantibus in der Doctrin und der österreichischen Gesetzgebung' in *Festschrift zum siebzigsten Geburtstage Sr Excellenz Dr Joseph Unger überreicht von der Rechts- und Staatswissenschaftlichen Fakultät der KK Universität Wien am 2 Juli 1898* (J. G. Cotta'schen Buchhandlung 1898), p. 223, 304.

⁸⁷⁶ The Code Civil applied to the territory left of the Rhine occupied by France.

⁸⁷⁷ See Ch. 4.02.

⁸⁷⁸ Thibaut arguing for a general code and Savigny against (see. Zimmermann, 'Savigny's Legacy: Legal History, Comparative Law, and the Emergence of a European Science' (1996) 112 *Law Quarterly Review*, at 576 – 577; Hattenhauer, *Thibaut und Savigny* (Verlga Franz Mahlen Muenchen 1973)).

meant that the equitable doctrine lost its appeal.⁸⁷⁹ The motives underpinning the German civil code⁸⁸⁰ show that the principle of 'clausula rebus sic stantibus' was meant to apply only to loan contracts (what then became § 610 of the old BGB)⁸⁸¹ where the circumstances of the other party to repay the loan had changed and no money had yet been paid.⁸⁸² For the purposes of this chapter it meant that the principle of clausula rebus sic stantibus had not been included in the codification of the BGB.

6.04 German Law - The Resurrection of 'Clausula Rebus Sic Stantibus'

In 1888, in the *Brandy Case*,⁸⁸³ a tax was levied on all brandy. This made the sale price the parties had agreed lower than the actual tax on the brandy. The court held that 'clausula rebus sic stantibus' did not apply and that the contract would

⁸⁷⁹ Roesler, 'Hardship in German Codified Private Law - In Comparative Perspective to English, French and International Contract Law' (2007) 3 *European Review of Private Law*, 487-489; Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (Clarendon Press 1996), p. 581; Though there were writers such as Windscheid that advocated the doctrine of tacit presupposition (See Windscheid, 'Die Voraussetzungen' (1892) 78 *Archiv fuer die civilistische Praxis* 197).

⁸⁸⁰ Mugdan, *Die Gesamten Materialien zum Bürgerlichen Gesetzbuch für das Deutsche Reich*, vol 3 (R. v. Decker 1899), p. 199.

⁸⁸¹ *A person who promises to make a loan may, in case of doubt, revoke the promise if a serious worsening in the financial circumstances of the other party comes about whereby the claim to repayment is endangered.*

⁸⁸² '[...] den Ruecktritt wegen veränderter Umstände – clausula rebus sic stantibus – laesst der Entwurf in einem Falle zu, nämlich bei dem Vertrage, durch welchen die Hingabe eines Darlehens versprochen wird'.

⁸⁸³ RGZ 21, 178 (*Brandy Case*) .

therefore not be adapted to the changed circumstances. In coming to this conclusion, the court first considered whether it had become impossible to deliver the wine and held that the tax had not made it impossible.⁸⁸⁴ The court further discussed whether there may have been a mistake and whether therefore the parties did not intend to enter into that contract or would not have entered into the contract had they known of the tax. The facts suggest that there had been deliberations about this new tax during the time the parties negotiated their contract. This seems to have influenced the judges in their decisions particularly as a remarkably similar case, decided on the basis of the ALR in 1883,⁸⁸⁵ held that 'clausula rebus sic stantibus' applied and the contract was adapted to the changed circumstances.

In 1902, in the *Petroleum Delivery Case*,⁸⁸⁶ the German Supreme Court held that the motives to the BGB did not allow any space for the principle of clausula rebus sic stantibus to be included.⁸⁸⁷ They did however leave a back door open in that the court would be allowed to conclude that the parties had meant to include the provision, taking into account the custom of the particular business.⁸⁸⁸ The question

⁸⁸⁴ Ibid. at 179.

⁸⁸⁵ RGZ 10, 233 .

⁸⁸⁶ RGZ 50, 255 (*Petroleum Delivery Case*) .

⁸⁸⁷ '[...] dass es sich hier nicht um Anwendung eines allgemeinen Prinzips [...] handelte.' (ibid. at 257).

⁸⁸⁸ Ibid. 258: '[...] in jedem Einzelfalle weiter zu prüfen sein, ob nicht nach der Absicht der Parteien der Rücktritt wegen veränderter Umstände der einen oder anderen Partei zustehen soll, und es wird bei dieser Prüfung nach §346 BGB auf die im Handelsverkehr geltenden Gewohnheiten und Gebräuche,

in the petroleum delivery case was whether the change in one party's economic circumstances would be enough to allow the other to cancel the contract.

Though it is generally assumed that the principle of *clausula rebus sic stantibus* was not used until the 1920s (after the inflation cases),⁸⁸⁹ the *Swimming Pond Case*⁸⁹⁰ of 1917 indicates that the courts may have been using other ways of reaching the same conclusion. The defendant had taken on a long lease of a shop next to a popular swimming pond. After war broke out swimming on that pond was forbidden. The defendant argued that they should be released from their obligations to pay the rent. The court held that because the reason for which the shop had been leased was obstructed by the war-time restrictions, the defendant was to be released from his obligations even though the shop could have been used to serve the troops that were stationed there. The court argued that the troops had different needs⁸⁹¹ and that therefore the contract would have been entirely different. What was important was that the court first had to hold that there was a rental agreement (and not a lease) because they could then hold that there was a subsequent defect in the object of the rental agreement (i.e. a lease would have only covered the ground without any particular purpose whereas a rental

sowie nach §157 BGB auf das, was Treu und Glauben mit Rücksicht auf die Verkehrssitte fordert, Rücksicht zu nehmen sein.'.

⁸⁸⁹ Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (Clarendon Press 1996), p. 582; Roesler, 'Hardship in German Codified Private Law - In Comparative Perspective to English, French and International Contract Law' (2007) 3 *European Review of Private Law*, 487.

⁸⁹⁰ RGZ 91, 54 (*Swimming Pond Case*) .

⁸⁹¹ Thereby distinguishing the case from RGZ 4, 171 .

agreement would have had the purpose of the shop as a condition) which would allow the contract to be brought to an end. The reasoning, it would seem, was based on the fact that generally in cases where there was a rental agreement the risk allocation demanded that it should be carried by the owner and that this principle could be transferred.⁸⁹²

In 1911, in the *Petrol Station Case*⁸⁹³ the court held that the landlord was not entitled to the rent, firstly because the petrol station was being used by local authorities and secondly because there was little (or in some cases no) petrol to be sold. They acknowledged that this did not mean that it was in fact a flaw in the product according to § 323 BGB but (according to what was then § 537 BGB) had the same effect because it could not be used for the purpose for which it had been rented.⁸⁹⁴ In the *Lunapark Case*⁸⁹⁵ the lessee of a dance club refused to pay rent due to a war-time ban on dancing. The court held that both parties were aware that the club had been leased for this purpose and therefore the lessee was relieved

⁸⁹² 'so hat es auch der Vermieter zu tragen[...] von einem ihre Tauglichkeit zu dem vertragsmäßigen Gebrauch aufhebenden Verbot betroffen wird. '

⁸⁹³ RGZ 94, 267 (*Petrol Station Case*) .

⁸⁹⁴ The court achieved this by using the combination of §323 (1) BGB ('If, in the case of a reciprocal contract, the obligor does not render an act of performance which is due, or does not render it in conformity with the contract, then the obligee may revoke the contract, [...]') and specifying that § 537 (1) BGB is the exception: 'The lessee is not released from his obligation to pay rent due to the fact that, for a reason relating to his person, he is unable to exercise his right of use. [...]'. This means that in cases where it is not 'relating to his person' the lessee is released from his obligations.

⁸⁹⁵ RGZ 87, 277 (*Lunapark Case*) or in RGZ 88, 96 (*Wine-Bar Case*) .

from having to pay rent for the time of the ban. The basis of the decision seemed to be that a condition of the contract was that the premises could be used as a dance club and because this was not possible there was a flaw in the rented object.

The German Supreme Court has used 'clausula rebus sic stantibus' in other ways, despite their statement that this was not a principle to be applied generally but was confined to the particular facts of the case. In 1905⁸⁹⁶ the court used the principle to reach an entirely different conclusion on a similar topic, the creditworthiness of the company. The case concerned the take-over of a German insurance company by an English company. The individuals that had taken out insurance contracts claimed to be released from the contract on the basis that the circumstances had significantly changed. The argument was that firstly the company was not the same one they had originally signed up to and secondly that the value guaranteed was now watered down due to the take-over. It was not clear how much of the money would still be accessible to fulfil claims in Germany, with restrictions placed on how much money could be 'exported'. The court acknowledged that 'clausula rebus sic stantibus' did not apply as a general principle but also held that this did not preclude the court from assessing individual situations in light of the principle. In other words, the court could consider whether there was any way of finding that the parties had incorporated the principle into the contract through

⁸⁹⁶ RGZ 60, 56 (*English Insurance Provider Case*).

interpretation.⁸⁹⁷ The court held that there was sufficient evidence to suggest that the value of the insurance company (in relation to the German element) formed a basis of the contract and that this had been incorporated into the contract. It seems that this is the first time the court acknowledged that a change in the creditworthiness of a party can form the basis of the transaction. Here, the court used an implied term to avoid a result they did not agree with. However, the case may just be a product of its time because the fact that the company was not German seemed to play a role, in the sense that the German court of appeal evaluated the English legal systems in terms of adequacy of protection for the insured after the take-over.⁸⁹⁸

This principle was not applied universally. In the *Heidelberger Bierkrug Case*,⁸⁹⁹ for example, the fact that there was a limitation on the amount of beer that the pub was allowed to brew did not (according to the court) have enough impact on the nature of the pub to warrant a reduction in the rent. The court distinguished the case from the *Lunapark Case*⁹⁰⁰ and *Swimming Pond Case*⁹⁰¹ on the basis that the purpose for which the property had been let was still available and that it was up to

⁸⁹⁷ Ibid. at p. 59, *Damit ist jedoch die Prüfung nicht ausgeschlossen, ob nicht im einzelnen Falle oder auch bei einer ganzen Gattung von Verträgen nach der Absicht der Parteien und nach der Natur der Verträge ein Rücktrittsrecht wegen veränderter Umstände gegeben ist*.

⁸⁹⁸ Ibid. at p. 62 '[...] auch dann nicht, wenn die Gläubigerschutzvorschriften des englischen Rechts für minderwertig gegenüber denen des deutschen Rechts erachtet würden'.

⁸⁹⁹ RGZ 90, 374 (*Heidelberger Bierkrug Case*).

⁹⁰⁰ RGZ 87, 277 (*Lunapark Case*).

⁹⁰¹ RGZ 91, 54 (*Swimming Pond Case*).

parliament to include a reduction in the rent in the legislation. The court also restricted the approach in the above cases to rental agreements.

With the hyperinflation that followed World War One, the Reichsgericht was faced with a string of cases where the level of the price had increased by over 1400 times the original cost. The court therefore resorted to using the doctrine of impossibility under § 275 (1) BGB and created the concept of economic impossibility.⁹⁰² It would seem that one of the first cases to re-consider the idea of impossibility, was the case *Roland*.⁹⁰³ The buyer had ordered a particular type of flour, 'Roland', to be delivered from June to October at 100 bags a month. This type of flour was only produced in the seller's mill, which had burnt down. The mill was quickly rebuilt but the flour could not be delivered until the following year's crop had been harvested. The court held that as the flour was severely dependent on the economy that the contract was limited to that particular crop of that year. It also added that the delay caused by the fire meant that the content of the contract would have changed entirely and that therefore the contract had become impossible to perform.⁹⁰⁴ A similar case, *Eichenlaub*,⁹⁰⁵ arose where before the fire some of the flour (with the name of 'Eichenlaub') had been shipped to a different buyer. The claimant argued

⁹⁰² RGZ 94, 45 (*Copper Sale Case*); RGZ 100, 129 (*Steam Delivery Case*) - although see below on the distribution of losses.

⁹⁰³ RGZ 42, 114 (*Roland Case*).

⁹⁰⁴ Note that the approach to cases where it was temporarily impossible to perform the contract changed from the pure interpretation of the contract to a more flexible approach in BGHZ 83, 197, 200 - based on good faith.

⁹⁰⁵ RGZ 57, 116 (*Eichenlaub Case*).

that this flour was still 'on the market' and in light of what was then § 279 BGB⁹⁰⁶ the court would have had to find that the flour was still available on the market and could be re-purchased. However, the court disagreed and held that it would be contrary to good faith to expect the seller to recover the flour.⁹⁰⁷ The court, in both cases, took a narrow view of what had been promised⁹⁰⁸ and in the cases that followed extended that interpretation implying a condition that incorporated the reason for which the parties had entered into the contract.

Not long after⁹⁰⁹ the court decided that §275 (1) BGB was not the correct device for dealing with these kinds of cases and based their decision on Oertmann's theory which effectively was 'clausula rebus sic stantibus'. However, they did add the proviso that not allowing the other party to adjust the contract was contrary to good faith under § 242 BGB.⁹¹⁰ At this point then it seems that the courts concluded that in exceptional circumstances, based on the will of the parties, the principle of sanctity of contract is displaced but only in so far as the other party has been given the possibility to accept an adjustment of the contract. From here the court

⁹⁰⁶ And what is now § 276 (1) BGB.

⁹⁰⁷ RGZ 57, 116 (*Eichenlaub Case*), 118.

⁹⁰⁸ Ruethers, *Die unbegrenzte Auslegung* (Mohr Siebeck Verlag 2012), p.15.

⁹⁰⁹ RGZ 103, 328 (*Spinning Works Case*).

⁹¹⁰ It would seem that some commentators (e.g. See Roesler, 'Hardship in German Codified Private Law - In Comparative Perspective to English, French and International Contract Law' (2007) 3 *European Review of Private Law*, 488) have concluded that the decision was based entirely on § 242 BGB but the court seems to have in fact followed the principle of implying a term (namely *clausula rebus sic stantibus*) and then later relying on § 242 BGB.

developed the idea that if the equivalence of the contract had been disturbed significantly it could be 'unduly burdensome' to hold the parties to the original agreement. In fact, the court held that if '*as a result of entirely changed circumstances that are significant for the fulfilment of the contract, the completion of the contract on the basis of the old conditions could not reasonably be expected of the other party.*'⁹¹¹ The case involved a contract made in 1915 by the sole distributor for Opel cars for the south of Germany and several customers, to deliver cars immediately after the war had finished. The court held it would be unreasonable to force the delivery of the cars in light of the damage the war had caused.⁹¹² It was, however, not only the changed circumstances that led the court to their conclusion but the fact that if the car dealer had to deliver the car (and therefore deliver other cars to around 20-30 other clients) it would cause him financial ruin. There were two questions for the courts to answer, the first was whether the defendant could rely on contracts entered into with other customers in order to show that fulfilment of the contract would be ruinous to him and the second was whether the fact that it was ruinous to him was sufficient for the court to intervene on the basis of good faith. The court held that the dealer could refer to the other contracts to prove his financial ruin and that this was sufficient. This conclusion seems to indicate that the court attached more value to the dealer's but also the company's (Opel) continued existence than to that of the contract. Again, the socio-economic circumstances of the time must be taken into consideration.

⁹¹¹RGZ 100, 134 (Opel Case) , 134.

⁹¹² A similar case RGZ 101, 79 .

‘Opel’ was a major German producer. In 1907 they had won the price for fastest car in the Taunus races and were therefore named ‘kaiserlicher Hoflieferant fuer Automobile’ (‘imperial purveyor’), in 1911 their factory had been destroyed in a large fire, and in 1914 the company produced trucks for the army. The ruin of the main dealership would have had a knock-on effect on Opel and would have probably caused the company financial hardship. Any such action would probably have caused a public outcry in light of the war and would have probably also been contrary to the public interest. The reasoning that it was ‘unduly burdensome’ for the individual was therefore linked to the needs of society.

Originally the courts held on to the idea that the change in equivalence had to be sufficiently significant that forcing the parties to hold on to the original contract would cause financial ruin to one of the parties. In the *Energy Delivery Case*⁹¹³ the court held that the burden on the delivery company was not ‘*such as would be considered [...] an unjust ruin*’ for the claimant⁹¹⁴ and that therefore the certainty of continuation of the contractual arrangement was more important. In this case though the courts explicitly use the phrase *clausula rebus sic stantibus* which indicates that they are falling back on the Roman traditions of the principle.

Only a few years later the *Steam Delivery*⁹¹⁵ case reached the German Supreme Court. In brief the claimant was the landlord of the property who wanted the rent to be adjusted to take account of the economic change that had caused the cost for

⁹¹³ RGZ 99, 258 (*Energy Delivery Case*).

⁹¹⁴ Ibid. 258.

⁹¹⁵ RGZ 100, 129 (*Steam Delivery Case*).

the delivery of steam to increase significantly. It was not in this case a simple matter of just releasing the parties from their obligations as the steam had already been delivered and the court held, in stark contrast to the *Energy Delivery Case*,⁹¹⁶ that the contract should be adapted. By now the effects of the war had become abundantly clear and the court decided to adapt the contract to the new circumstances. The adaptation of the contract was not supposed to place the burden of the increased cost on the other party but was meant to be spread across both parties.⁹¹⁷ The courts used the *Steam Delivery Case*⁹¹⁸ to allow for the contract to be adapted. This almost revolutionary new step was justified by the courts' need to step in and adapt contracts to the changes of life particularly after the war. This rather emotional response, Markesinis argues, erupted from the dissatisfaction with the government's failure to address the problems (particularly of inflation).⁹¹⁹ It was clear from then that the difficulties of a change in equivalence could not be solved by simply relying on the financial ruin of one of the parties⁹²⁰ and was subsequently replaced by a general principle of equivalence based on general

⁹¹⁶ RGZ 99, 258 (*Energy Delivery Case*).

⁹¹⁷ Ibid. at 260: *„Es darf ihm nicht der ganze Nachteil aufgebürdet werden, so dass nunmehr der Zustand für ihn ein nicht erträglicher sein und der Billigkeit und Gerechtigkeit widersprechen würde“*.

⁹¹⁸ RGZ 100, 129 (*Steam Delivery Case*)

⁹¹⁹ Markesinis, Unberath and Johnston, *The German Law of Contract: A Comparative Treatise* (2nd edn, Hart Publishing 2006), p. 329 – 332.

⁹²⁰ Nauen, *Leistungerschwerung und Zweckvereitelung im Schuldverhältnis - Zur Funktion und Gestalt der Lehre von der Geschäftsgrundlage im BGB und im System des Reformentwurfs der Schuldrechtskommission* (Duncker & Humboldt 2001), p. 73.

unreasonableness.⁹²¹ The courts built in a two-step process, thereby avoiding what was then §§ 275, 323 BGB, by allowing the party to withdraw from the contract only if he had without avail asked the other party for an increase (of money or whatever had decreased).⁹²²

In taking this approach the court turned their back on the principle of nominalism and *pacta sunt servanda* to uphold the equivalence set by the parties on the basis of the parties' supposed intention when they entered into the contract.

Oertmann⁹²³ attempted to summarise and developed the existing discussion on the foundation of the transaction.⁹²⁴ Oertmann's theory was *'the foundation of the transaction is that which becomes clear and is accepted as important by the other party and not objected to, or it is the shared belief of both parties of the existence or future existence of particular circumstances, on the basis of which the will to contract was based.'*⁹²⁵ In 1921 Oertmann published his work on the 'basis of the transaction' and it was not long before the German Supreme court picked up the

⁹²¹ See for example the *RGZ 103, 177 (Steel Cable Case)*.

⁹²² *RGZ 106, 7, 11; RGZ 107, 124, 128.*

⁹²³ Oertman, *Die Geschäftsgrundlage: Ein neuer Rechtsbegriff* (Scholl 1921), p.2.

⁹²⁴ See Lenel, 'Die Lehre von der Voraussetzung' (1889) *AcP*, p. 23.

⁹²⁵ Oertman, *Die Geschäftsgrundlage: Ein neuer Rechtsbegriff* (Scholl 1921), p.37:

'Geschäftsgrundlage ist die beim Geschäftsschluss zutage tretende und vom etwaigen Gegner in Ihrer Bedeutsamkeit erkannte und nicht beanstandete Vorstellung eines Beteiligten oder die gemeinsame Vorstellung der mehreren Beteiligten vom Sein oder vom Eintritt gewisser Umstände, auf deren Grundlage der Geschäftswille aufbaut.'

idea. In 1922 the courts held in the *Spinning Works Case*⁹²⁶ that fundamental circumstances are ‘*perceptions shared by both parties as evident at the closing of the contract, or perceptions of one party, discernible to and not objected to by the other party, of the existence, present or future, of certain circumstances that form the basis of their willingness to contract.*’⁹²⁷ These post-inflation cases⁹²⁸ openly acknowledge the use of Oertman’s theory of the ‘disappearance of the transaction’ (Wegfall der Geschäftsgrundlage) and it seems from here there was no question as to the existence of the doctrine. What was left to be decided was the basis of the consequence, i.e. the adjustment of the contract or release of the parties from their respective obligations. In the *Spinning Works Case*⁹²⁹ plant was sold due to the company going into liquidation. Payment was to be made in two instalments. Even before the first payment was made inflation meant that the value of the money had significantly dropped and the court released the parties from their contract on the basis of §242 BGB.⁹³⁰ However, this was not before adding a further condition that indicates the same value as in the *Steam Delivery Case*,⁹³¹ namely that the party

⁹²⁶ RGZ 103, 328 (*Spinning Works Case*), see particularly at p. 332.

⁹²⁷ Ibid.; RGZ 104, 394; RGZ 168, 121, 126.

⁹²⁸ E.g. RGZ 103, 328 (*Spinning Works Case*); RGZ 104, 394.

⁹²⁹ RGZ 103, 328 (*Spinning Works Case*), 332.

⁹³⁰ Note that Nauen argues that the courts only adhered to Oertmann’s ideas superficially (Nauen, *Leistungserschwerung und Zweckvereitelung im Schuldverhältnis - Zur Funktion und Gestalt der Lehre von der Geschäftsgrundlage im BGB und im System des Reformentwurfs der Schuldrechtskommission* (Duncker & Humboldt 2001); p. 82.

⁹³¹ RGZ 100, 129 (*Steam Delivery Case*).

relying on the changed circumstances must provide the other party with the opportunity to adapt to the new circumstances. In other words, should the other party be willing to change the purchase price to match the inflation, he must be given that opportunity.

The court's approach of adapting the contract and Oertmann's concept of the foundation of the transaction were finally brought together in the *Luederitzbucht Case*⁹³² – another inflation case. This idea was carried over into the LAG cases⁹³³, where property that had been taken during the war (or had been particularly badly destroyed) and was then handed back to the original owners but with the possibility of additionally receiving 'compensation' from the government. It was not always certain how much property owners would receive. In some cases where the property was sold, the buyer and seller estimated how much they would be receiving and added this to the purchase price. However, in a few cases it turned out that the buyer received significantly more than expected. The court held in these cases that the purchase price should be adapted to the changed circumstances. It is difficult in these cases to see what exactly the previous owner of the property had lost. It seems that the courts were more interested in ensuring that the new property owners were not enriched. The court justified that in some cases the new owners would receive the property for 'free' and that this was 'so manifestly contrary to the parties' consideration of equivalence that it had to be rectified.

⁹³² RGZ 107, 78 (*Luederitzbucht Case*).

⁹³³ BGH WM 1958, 297 (*LAG Case*).

This is an interesting shift in approach. It seemed that in other cases it was the protection of the party that suddenly would receive nothing in return for their delivery or where it would cost more to produce than what they would get for the object. In these cases it was about avoiding one party going bankrupt and avoiding the consequent harm to society. In the LAG cases⁹³⁴ the value of the money remained the same and it was then just a matter of the buyer being lucky when they received the property for 'free'. There are two possible explanations for this shift. The first is that the court considered the equivalence to apply to these kind of cases and that this would in effect mean that the buyer is enriched. This could in consequence be similar to 'taking advantage' of the party that did not know the value of the property – behaviour which is contrary to good faith. The more likely explanation is that the LAG cases were aimed at compensating those who had lost their land (or use of their land) during the war. It would have been easier for the relevant government body to administer the compensation by attaching it to the land rather than trying to trace the owners of the land. It would mean that the people at whom the compensation was aimed would not be receiving their compensation and that others would be enriched. However, even working on the basis of the last assumption it seems that the court was aiming to uphold the equivalence of the transaction even where there had been no detriment and most importantly the court was willing to adjust the contract to give way to that equivalence.

⁹³⁴ E.g. Ibid.

The BGH followed the approach taken by the Reichsgericht. In the *Drill-Hammer case*,⁹³⁵ the buyer had ordered a number of these drills to be delivered to the west of Germany that were then to be sold in the east of Germany. As the delivery to the east of Germany was forbidden (or a large tax would have been levied on the products) the contract in itself remained possible but the buyer was unable to sell the amount of drills through other distribution channels. The German Supreme Court first held that generally the motive for entering into the contract was not the basis of the transaction except in cases where the will of both parties was based on that motive.⁹³⁶ In this case though it was only the motive of one party and therefore the contract must remain in force. However, the court adapted the contract by using § 242 BGB and reducing the number of drills the buyer was obliged to accept to the number of drills that had already been produced (1/4). The difficulty in this case is firstly, the buyer's subjective foundation of the transaction should not really be of concern for the seller, secondly, the contract was not impossible (the parties just did not know how long the blockade would last) and thirdly the equivalence had not changed. It would seem therefore that in this case the court was willing to forgo their inhibitions for removing the limitations on the intervention on freedom of contract to ensure that the contract made commercial sense. The conclusion that must be drawn from this is that the court was insisting on an ongoing duty of the

⁹³⁵ BGH LM § 242 (Bb) BGB Nr. 12 (*Drill Hammer Case*) (for a translation of the main facts see Beale and others, *Contract Law: Ius Commune Casebooks for Common Law of Europe* (2nd edn, Hart Publishing 2010), p. 1142) and later the BGH NJW 1972, 1703 (*Polish Beans Case*) ; BGH WM 1978, 323 (*Oil Crisis Case*) ; BGH JZ 1994, 626 (*Porsche 959 Case*).

⁹³⁶ BGH LM § 242 (Bb) BGB Nr. 12 (*Drill Hammer Case*).

seller to take into account the buyers need in cases where the circumstances have changed.

6.05 Reform of the BGB and § 313 BGB

The cases above formed the basis for the implementation of the principle of 'disruption of the foundation of the transaction' ('Störung der Geschäftsgrundlage') into the BGB. § 313 (1) BGB relates to cases where the objective basis of the contract has been disrupted:

(1) If circumstances which became the basis of a contract have significantly changed since the contract was entered into and if the parties would not have entered into the contract or would have entered into it with different contents if they had foreseen this change, adaption of the contract may be demanded to the extent that, taking account of all the circumstances of the specific case, in particular the contractual or statutory distribution of risk, one of the parties cannot reasonably be expected to uphold the contract without alteration.

§313 (2) BGB relates to cases where the parties' basis of the contract has been disrupted, i.e. their common belief in a certain state of affairs that is foundational to their contract: ⁹³⁷

(2) It is equivalent to a change of circumstances if material conceptions that have become the basis of the contract are found to be incorrect.

§ 313 (1) BGB applies to cases where after the contract has been entered into the basis of the contract has changed significantly and had the parties known of this

⁹³⁷ § 313 (3) BGB will be dealt with at a later point.

change they would not have entered into the contract (or would have entered into the contract on different terms). It is then added that in accordance with good faith and particularly taking into account the allocation of risk the obligor should not be expected to carry the burden of the change in circumstances. It is clear from the explanatory notes that § 313 BGB is designed to codify the already existing case law without making any changes.⁹³⁸ This means that reference to cases prior to the reform of the BGB will apply in the same way today.

According to § 313 (2) BGB, if important beliefs have become the foundation of the contract and those beliefs turn out to be mistaken the parties will be released from their obligations under the contract. According to the motives of the reform⁹³⁹ this is to include cases where both parties were mistaken as to the motives⁹⁴⁰ and cases where one person is mistaken as to the motives and the other party has accepted these ideas. The cases that were difficult to bring within § 119 (2) BGB⁹⁴¹ are to be solved by § 313 (2) BGB. However, if both parties were mistaken as to the motives and these were considered essential in business it would seem odd not to solve the cases according to § 119 (2) BGB. Huber argues here that there may still be a development in the courts towards attributing these cases back to § 119 (2) BGB.⁹⁴²

⁹³⁸ Bundestages, *Entwurf eines Gesetzes zur Modernisierung des Schuldrechts 14.05.2001 – 14/6040*, p. 175.

⁹³⁹ Ibid. p. 176.

⁹⁴⁰ See for example *BGH LM § 242 (Bb) BGB Nr. 12 (Drill Hammer Case)*.

⁹⁴¹ I.e. they were considered essential in business. See Ch. 4.06.

⁹⁴² Huber and Faust, *Schuldrechtsmodernisierung- Einführung in das neue Recht* (2002), p. 233 RN 8.

6.06 The German Values

It is clear from the above discussion that the idea that certain fundamentally changed circumstances could and should affect the contract was already a principle in Roman law. It is also clear that the German courts have been (and probably still are) unsure about the extent to which this principle should be applied and what the basis of the principle is. The inflation cases allowed the courts to move away from the principle of nominalism to the principle of equivalence in exchange. Of course the motivation, so it seems, was the dissatisfaction with the legislators' inaction in providing a legislative solution to the devaluation of the currency. This does not preclude the conclusion that the equivalence of the exchange in a bargain is a fundamental value and this is underlined by the courts' insistence on adjusting, rather than ending, the contractual relationship. The contract, and this must be a further fundamental value, as a promise of performance is to be upheld but this can then mean allowing only partial performance or adjusting the contract in cases of temporary impossibility.

Though this may seem like a practical approach to changed circumstances it does impede on at least two other values, namely freedom of contract and the autonomy of the individual. Freedom of contract is limited by the courts' intervention into the contractual deal whether they find that the contract is void or have decided to adjust the agreement. Though this also applies to the autonomy of the individual this value is limited further in cases where the contract is adjusted because the court is effectively imposing a new deal on the parties that neither had contemplated at the outset and (probably) neither had wanted when they were making the contract. The scale therefore slides in direction of upholding the

contract to the detriment of freedom of contract and the autonomy of the individual. The autonomy of the individual is intrinsically linked to the will-theory⁹⁴³ and it seems here that although the court is imposing a hypothetical will on the parties it is not the parties' will (and if it were then they would have anticipated the event which in turn means that they would have made a different agreement).

Continuing on from the hypothetical will of the parties it would seem that the German courts are willing to underpin the existing contractual relationship with a 'safety-net' to protect what (in their eyes) the parties may have agreed had they foreseen the event. In cases where there is simply a devaluation of the currency this seems largely to be a matter of adjusting the scale. However, where it has become more burdensome (e.g. the *Drill-Hammer Case*⁹⁴⁴, or the *Swimming Pond Case*⁹⁴⁵) it seems that this is an adjustment of the risk allocation that in this case chance has set. There are two elements that can be deduced from this approach. The first is that the court is imposing a standard of reasonable conduct in cases where there has been a fundamental change in circumstances, based on what a reasonable person would have agreed had they known of the facts. The second is that in doing so the court is assuming that whatever the circumstances may be the parties 'will' must be to continue the contractual relationship. The conclusion that must therefore be drawn from this is that the court is not protecting the contract between the parties but the (contractual) relationship between the parties.

⁹⁴³ See Ch. 4.02 and Ch. 4.03.

⁹⁴⁴ BGH LM § 242 (Bb) BGB Nr. 12 (*Drill Hammer Case*).

⁹⁴⁵ RGZ 91, 54 (*Swimming Pond Case*).

Chapter 5 revealed the court's underlying value of protecting society as a whole. In cases such as the *Opel Case*⁹⁴⁶ the court seems to have focused on the importance of a particular industry at the time and thereby protecting not only society but also the economic viability of the judgment. Refusing to adjust the contract would have meant bankruptcy for a major industrial force which would have surely had knock-on effects for the economy and national spirit of the time. Though this may be the exception to the rule it does fit into the underlying thought of section above, namely the continuation of the contractual relationship - an impossibility if the distributorship for south Germany were to go bankrupt.

The LAG cases⁹⁴⁷ may just be a one-off reversal of the principle in that the seller of the property would not have technically 'lost' anything due to changed circumstances but that really it was an unforeseen gain to the buyer. In the eyes of the court this seems to be manifestly unjust but the basis of the principle, it is argued here, may be no other than the principle of equivalence mentioned above. The court is thereby trying to reinstate the original bargain and must therefore remove equalise the 'unjust' gain made by the seller.

6.07 The English Approach: Introduction

The explanation of the German law began with the law on impossibility before moving on to impracticability. The same will be true for the section on English law. However, in order to cover all the cases that in Germany are caught by the principle of § 313 BGB, the doctrine of common mistake must also be taken into account.

⁹⁴⁶ RGZ 100, 134 (*Opel Case*).

⁹⁴⁷ E.g. BGH WM 1958, 297 (*LAG Case*).

This part of the chapter will first set out the approach to common mistake and then go on to discuss the general law on impossibility. It will then become clear that there is no general doctrine to deal with the adjustment of long-term contracts which has led the courts firstly to stretch the existing principle of frustration and secondly to use alternative techniques in order to achieve (at least in some cases) similar results. It will be suggested that the approach varies over time and that there may still be room (at least in construction contracts) for the principle of cardinal change.

6.08 Common mistake in English Law

The main difference between common mistake and frustration is that in the common mistake cases the event must have happened before the contract was signed.⁹⁴⁸ This would occur for example where upon signing the contract the goods had already perished. It would seem that the doctrine itself is a fairly recent import from the civil law,⁹⁴⁹ which may also explain the narrow parameters of the doctrine. In *Bell v Lever Brothers* two company directors had agreed, in exchange for compensation, to leave the company early. It later transpired that they had been involved in behaviour that breached their duties which meant that they could have been dismissed without the need to compensate. The court held that there was no common mistake. Since then the courts have attempted to find a coherent theory

⁹⁴⁸ See for example Radcliffe LJ in *Davies Contractors v Fareham Urban DC* [1956] AC 969.

⁹⁴⁹ MacMillan, *Mistakes in Contract Law* (Hart Publishing 2010), p.190 ff.; Beale and others, *Contract Law: Ius Commune Casebooks for Common Law of Europe* (2nd edn, Hart Publishing 2010)p. 486.

on common mistakes, by relying on the implication of terms⁹⁵⁰, which was later rejected⁹⁵¹ in the *Great Peace Shipping*.⁹⁵² In *Great Peace Shipping Ltd v Tsavliris Salvage (International) Ltd (The Great Peace)*⁹⁵³ the court drew a parallel with the doctrine of frustration which meant that for common mistake to avoid the contract the non-existence of the state of affairs must have made contractual performance impossible. One of the main points though is that in common mistake cases the contract is either void or valid, and there is no room for the court to adjust the contract.

6.09 Frustration in English Law

The law of frustration allows the parties to be relieved from their duties under the contract once it has become impossible for one of them to perform their side of the bargain. There are several limitations to this approach, for example that self-induced frustration or subjective impossibility will not lead to relief.

English law is generally reluctant to allow for relief on the basis of frustration if it would have been possible to provide for the eventuality in the contract. In the

⁹⁵⁰ E.g. Lord Atkin in *Bell v Lever Bros Ltd* [1932] AC 161; Slade, 'The Myth of Mistake' (1954) 70 Law Quarterly Review 385.

⁹⁵¹ Note that the implication of terms was still used in *Associated Japanese Bank (International) Ltd v Credit du Nord SA* [1989] 1 WLR 255 (QB).

⁹⁵² *Great Peace Shipping Ltd v Tsavliris Salvage (International) Ltd* [2002] EWCA Civ 1407 (CA), at 73: 'First that the theory of the implied term is as unrealistic when considering common mistake as when considering frustration.' (see also *National Carriers Ltd v Panalpina (Northern) Ltd* [1981] AC 675 (HL)).

⁹⁵³ *Great Peace Shipping Ltd v Tsavliris Salvage (International) Ltd* [2002] EWCA Civ 1407 (CA).

landmark case of *Paradine v Jane*⁹⁵⁴ a tenant of a farm had been dispossessed of his land for three years. This prevented him from using the land. The court held that⁹⁵⁵ *‘when a party by its own contract creates a duty or charge upon himself, he is bound to make it good, if he may, notwithstanding any accident by inevitable necessity, because he might have provided against it by his contract.’*⁹⁵⁶ However, the rule was relaxed in the mid-19th century. The revised approach held a contract to be frustrated in cases where the subject matter of the contract had been destroyed⁹⁵⁷ without the fault of either party and it had therefore become impossible to perform the contract and the event had not been foreseen by the parties.⁹⁵⁸ In *Taylor v Caldwell*⁹⁵⁹ the music hall where the concert was to be performed burnt down.⁹⁶⁰

⁹⁵⁴ *Paradine v Jane* 82 Eng Rep 897.

⁹⁵⁵ *Ibid.* 897.

⁹⁵⁶ This is a case where the purpose of the contract was frustrated. It serves here just to illustrate the courts approach to frustration cases. Cases where the purpose of the contract has been frustrated are discussed in more detail below.

⁹⁵⁷ In some cases partial destruction of the subject matter is sufficient. In *Taylor v Caldwell* [1863] 122 ER 309 (KB) the gardens and four walls of the music hall remained. See also *Asfar & Co v Blundell* [1896] 1 QB 123 (CA) where the cargo of the sunken ship was recovered but had to be sold for to be used for an entirely different purpose due to the contamination.

⁹⁵⁸ *Walton Harvey Ltd v Walker & Homfrays Ltd* [1931] 1 Ch 274 (CA).

⁹⁵⁹ *Taylor v Caldwell* [1863] 122 ER 309 (KB).

⁹⁶⁰ Note that it is unlikely that fire or the destruction of the subject matter of the contract in building contracts would frustrate the contract due to the fire insurance policies required in most building contracts.

The court held that the parties were released from their obligations under the contract as the contract was frustrated.⁹⁶¹

The same principle as in *Taylor v Caldwell*⁹⁶² applies where the subject matter of the contract has become unavailable,⁹⁶³ the thing essential for performance has been destroyed,⁹⁶⁴ where the method of performance has become impossible,⁹⁶⁵ or where in a personal contract the party performing the obligation has died.⁹⁶⁶ The contract may also be frustrated in cases where it has become illegal for the contract to be performed.⁹⁶⁷

⁹⁶¹ A statutory example of the same principle is s. 7 of the Sale of Goods Act 1979 where the contract is avoided if specific goods perish without the fault of either party.

⁹⁶² *Taylor v Caldwell* [1863] 122 ER 309 (KB).

⁹⁶³ *Re Shipton Anderson & Co* [1915] 3 KB 676 (KB) – where a particular parcel of wheat that had been contracted for was requisitioned.

⁹⁶⁴ See the example of the contract to paint frescoes and the church burns down; in Treitel, *Frustration and Force Majeure* (Sweet & Maxwell 2004); para 4-014.

⁹⁶⁵ *Nickoll & Knight v Ashton Edridge & Co* [1901] 2 KB 126 (CA) where it was specified that the seeds were to be shipped by the steamship called Orlando and that steamship ran aground. The route or method has to have been specified in the contract (*Tsakiroglou & Co Ltd v Noblee Thorl GmbH* [1962] AC 93 (HL)).

⁹⁶⁶ E.g. *Stubbs v Holywell Railway Co* [1867] LR 2 Ex 311 – the death of a consulting engineer.

⁹⁶⁷ *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd* [1943] AC 32 (HL) where German forces had occupied the harbour to which the goods were supposed to be shipped. See also *Denny Mott & Dickson Ltd v James B Fraser & Co Ltd* [1944] AC 265 (HL) where the outbreak of law made the agreement to deal with timber illegal.

The decision in *Taylor v Caldwell*⁹⁶⁸ was based on an implied term which was the juristic justification for frustration. However, in *Davies Contractors Ltd v Fareham U.D.C.*⁹⁶⁹ the court held that the test should be that of a fundamental or radical change. In other words the court would have to question whether the literal performance of the contract would be something fundamentally or radically different from the obligation originally undertaken.

Overall, the courts have taken the 'fundamental or radical change' approach seriously which has resulted in a strict approach to cases where it has become more difficult to perform the contract.

In the case of *Larrinaga & Co., Ltd. V Societe Franco Americaine des Phosphates de Medulla, Paris*⁹⁷⁰ the question arose whether contracts that had been made in 1913 and were to be performed in 1919 and 1920 could be held to be frustrated due to the First World War. Lord Summers addressed the issue by holding that the insecurities of contracting could generally be expressed in monetary terms and that therefore the fact that it had become more expensive to perform the contract could not form the basis of a claim in frustration.⁹⁷¹ This principle was followed in

⁹⁶⁸ *Taylor v Caldwell* [1863] 122 ER 309 (KB).

⁹⁶⁹ *Davies Contractors v Fareham Urban DC* [1956] AC 969.

⁹⁷⁰ *Larrinaga & Co Ltd v Societe Franco- Americaine des Phosphates de Medulla* [1923] 14 Ll L Rep 457 (HL).

⁹⁷¹ *Ibid.* at 463.

subsequent cases.⁹⁷² Particularly notable were the Suez Canal cases,⁹⁷³ where the Suez Canal was closed and the question arose whether due to the closure the contract was frustrated.⁹⁷⁴ The court held that the delivery had only become more expensive due to the fact that the ship could use an alternative (longer) route.

It seems that one of the main factors behind holding that the contract was not frustrated was that risk allocation, expressly or impliedly, limits the application of the doctrine of frustration. It has been held⁹⁷⁵ that there is no single approach on which the court can base the allocation of risk and that there is now the so-called 'multi-factorial approach'.⁹⁷⁶

'[...] the terms of the contract itself, its matrix or context, the parties' knowledge, expectations, assumptions and contemplations, in particular as to risk, as at the time of contract, at any rate so far as these can be ascribed mutually and objectively, and then the nature of the supervening event, and the parties' reasonable and objectively ascertainable calculations as to the possibilities of future performance in the new circumstances.'

⁹⁷² *Davies Contractors v Fareham Urban DC* [1956] AC 969.

⁹⁷³ *Tsakiroglou & Co Ltd v Noble Thorl GmbH* [1962] AC 93 (HL).

⁹⁷⁴ Later followed in *Kodros Shipping Corp of Monrovia v Empresa Cubana de Fletes (The Evia)* [1983] 1 AC 736 (HL) 751 E.

⁹⁷⁵ See for example *Chitty on Contracts* (Beale ed, Sweet & Maxwell, 2013) at 23-019.

⁹⁷⁶ *Edwinton Commercial Corp v Tsavliris Russ (Worldwide Salvage & Towage) Ltd (The Sea Angel)* [2007] 2 Lloyd's Rep 517 (CA) at [111].

Rix, L.J. then continued to place this multi-factorial approach to risk-allocation in the context of what was to be considered 'radically different':⁹⁷⁷

'Since the subject matter of the doctrine of frustration is contract, and contracts are about the allocation of risk, and since the allocation and assumption of risk is not simply a matter of express or implied provision [...], the test of 'radically different' is important: it tells us that the doctrine is not to be lightly invoked; that mere incidence of expense or delay or onerousness is not sufficient; and that there has to be as it were a break in identity between the contract as provided for and contemplated and its performance in the new circumstances.'

The statement by Lord Rix shows a general hostility to the doctrine of frustration because it interferes with the contractual or natural risk allocation.⁹⁷⁸ However, there have been some cases where the courts have been willing to stretch the meaning of impossibility. In *Krell v Henry*⁹⁷⁹ a room had been let for the sole purpose of viewing the procession of Edward VII. The king was ill and the procession was cancelled. The court held that the procession was the foundation of the contract and therefore the contract was frustrated.⁹⁸⁰ In fact in cases where parties entered into a contract after the procession had been cancelled the court

⁹⁷⁷ Ibid at [111].

⁹⁷⁸ Though it can be argued that the multi-factorial approach may also work in favour of frustration in cases such as *Pioneer Shipping Ltd v BTP Tioxide (The Nema) (No. 2)* [1981] 2 All ER 1030 (HL).

⁹⁷⁹ *Krell v Henry* [1903] 2 KB 740 (CA).

⁹⁸⁰ See also *Chandler v Webster* [1904] 1 KB 493 (CA); *Blakeley v Muller* [1903] 2 KB 760n; although see also the case of *Herne Bay Steam Boat Co v Hutton* [1903] 2 KB 683 (CA).

held that there was a common mistake.⁹⁸¹ However, it has since been held that the principle should not be extended.⁹⁸² Here, the court held that the contract was impossible even though it would have been perfectly simple to fulfil the contract, because the room could have been let without the view of the procession. There is also a special category of ‘delay cases’ where the courts have been willing to stretch the principle of ‘impossibility’.

In *Jackson v Union Marine Insurance Co. Ltd.*⁹⁸³ a ship was chartered to proceed with ‘*with all convenient speed*’ from Liverpool to Newport. In January the ship ran aground and by March it was clear that the repairs would take several months. The question would have been quite straightforward if the parties had agreed on a timescale for the voyage but in this case no time had been stipulated. The court held that despite the lack of stipulations as to time the delay meant that spring voyage would turn into an autumn voyage and therefore ‘*when the ship was ready might be twice as dangerous, and possibly twice as long, from fogs, ice, and other perils, though war might have broken out meanwhile*’.⁹⁸⁴ The court⁹⁸⁵ was therefore willing to imply a term into the contract, i.e. that it was meant to be a spring

⁹⁸¹ *Griffith v Brymer* [1903] 19 TLR 434.

⁹⁸² Per Lord Wright in *Maritime National Fish Ltd v Ocean Trawlers Ltd* [1935] AC 524 (PC), at 529.

See also *Amalgamated Investment & Property Co v John Walker & Sons* [1977] 1 WLR 164 (CA), where the purchaser of a property that later became listed was not permitted to escape the contract.

⁹⁸³ *Jackson v Union Marine Insurance Co Ltd* [1872-73] LR 8 CP 572 (CP).

⁹⁸⁴ *Ibid.* at 321.

⁹⁸⁵ Though not unanimously.

voyage, in order to allow the contract to be frustrated. It would seem that this was a particularly 'soft' approach to the definition of impossibility and it was a matter of essentially defining what could be considered 'impossible'. In fact it is rather unlikely that the court would take the same approach in cases today with a much higher expectation that the parties should have included a clause in the contract.

This approach though leads on to what can be called the 'requisitioning cases'.

These are cases⁹⁸⁶ where the parties have included a clause in the contract in the light of suspension by war but where the courts have still intervened on the basis that it would be an entirely different contract. During the First World War several vessels were held in the Baltic by the Russian authorities. In these cases the courts implied a term that if the contract became impossible for an uncertain duration of time the contract was to be considered frustrated.⁹⁸⁷

A further case that involved a delay but which was not literally impossible is *Metropolitan Water Board v Dick, Kerr & Co*,⁹⁸⁸ where the parties had contracted to build a reservoir within 6 years. The defendant was then required by the Minister of Munitions to stop work on the reservoir and sell their plant. The plaintiff claimed that a clause in the contract would have extended the 6-year period in the contract in case of unforeseen circumstances and that therefore the contract should be resumed at a later date. The court held that the obligation would be different if it were resumed after such delay and the contract was therefore frustrated. In this

⁹⁸⁶ E.g. *Admiral Shipping Co Ltd v Weidner Hopkins & Co* [1916] 1 KB 429 (KB).

⁹⁸⁷ *Ibid.* at 237-238.

⁹⁸⁸ *Metropolitan Water Board v Dick Kerr & Co Ltd* [1918] AC 119 (HL).

kind of case the courts seem to be taking the economic situation into account when making their decision. It seems difficult to infer anything else when the court refers to the contract being an entirely different one after the war except that the economic situation will have changed significantly and this it is suggested is probably as close to the 'equivalence cases' in Germany as one can get.

In all the above cases the courts were dealing with cases of frustration and in some cases they stretched the meaning of impossibility. It is not only the principle of frustration though that will provide relief in cases where there has been a fundamental change. In *Staffordshire Area Health Authority v South Staffordshire Waterworks Co*⁹⁸⁹ a hospital had entered into a contract with the local water works for the supply of water in return for not using a well for their own supply. The contract was to apply 'at all times hereafter'. The cost had risen to over 18 times the original amount between 1919 and 1975. Lord Denning held that the contract was frustrated on the ground that the circumstances had significantly changed but this was not the view adopted by the other judges. The rest of the Court of Appeal held that the agreement was for an indefinite period and could therefore be terminated upon reasonable notice. Even though Lord Denning may have wanted to see the decision in this case to be founded on frustration it was in fact decided

⁹⁸⁹*Staffordshire AHA v South Staffordshire Waterworks Co* [1978] 1 WLR 1387 (CA), see also the Irish case of *Irish Welding v Philips Electrical (Ireland) Ltd* (unreported, High Court, 8 October 1976), where it was held that if the contract for a distributorship contract is silent on the issue of termination then a reasonable notice should be implied.

by interpreting the existing clauses.⁹⁹⁰ This meant that the court was willing to interpret 'at all times hereafter' against its natural meaning in order to give way to justice. In fact the wording in the judgment itself is surprising. Lord Cuning-Bruce first observed that it was '*surprising that the parties should have deliberately decided to fix the cost of the supply of water forever*'⁹⁹¹ and then went on to say that '[t] words of the agreement are, of course a factor to take into account – and a factor of great importance – but are not to my mind sufficient to displace the inferences to be drawn from the other circumstances attending the formation of the agreement.' In other words, the court was willing to take perfectly clear words and under the guise of construction give those words an entirely different meaning. It is difficult here not to be reminded of the German inflation cases and there seems here to be a link, the value of the water (though the same object it was when the contract was made) had changed. It is quite clear from that same judgment though why the rest of the court did not accept Lord Denning's approach: '*I can find no authority which leads me to the view that the changing value of money has the effect in relation to domestic as compared international contracts of giving rise to*

⁹⁹⁰ Lord Denning has generally advocated for a more flexible approach to frustration cases. See for example *British Movietonews v London and District Cinemas* [1951] 1 KB 190 at 201 – 202: 'This does not mean that the courts no longer insist on the binding force of contracts deliberately made. It only means that they will not allow the words, in which they happen to be phrased, to become tyrannical masters. The court qualifies the literal meaning of the words so as to bring them into accord with the true scope of the contract. Even if the contract is absolute in its terms, nevertheless if it is not absolute in intent, it will not be held absolute in effect.'

⁹⁹¹ *Staffordshire AHA v South Staffordshire Waterworks Co* [1978] 1 WLR 1387 (CA), 1406.

*the operation of an implied term that the contract should only persist while money maintained the value or more or less the value that it had at the date of the formation of the agreement.*⁹⁹² The case seems therefore to be affirming the principle of nominalism⁹⁹³ in English law⁹⁹⁴ and this explains the rejection of Lord Denning's approach, since he advocated that in some cases it may be worth departing from the principle of nominalism, a principle that he had originally confirmed in *Treseder-Griffin v Co-operative insurance Society Ltd.*⁹⁹⁵ Nominalism, according to Lord Denning, was founded on the trust of creditors and debtors that had put their faith in the sterling currency. Commercial interests and certainty were therefore the overarching principles. However, with Lord Denning's departure from the rule it seems that he (and only he) saw a need to allow for cases of inflation to form an exception. It would seem from the above discussion that the court will have to go to great lengths where there has been a significant devaluation to do 'justice'.⁹⁹⁶

⁹⁹² Ibid, 1406.

⁹⁹³ *British Movietonews v London and District Cinemas* [1951] 1 KB 190.

⁹⁹⁴ It is unlikely that the principle was ever in doubt. The only exceptions seem to have been mentioned in *Gilbert v Brett* [1604] Davies Rep 18, 27 & 28; *Pilkington v Commissioners for Claims of France* [1821] 2 Knapp PC7, 20.

⁹⁹⁵ *Treseder-Griffin v Cooperative Insurance Society Ltd* [1956] 2 QB 127 (CA), 144.

⁹⁹⁶ There may be some argument to be made that the application of the principle has led to other difficulties in terms of interests on debts but this discussion is left to others. See Proctor, *Mann on the Legal Aspects of Money* (Oxford University Press 2005), para. 9.29-9.52.

One of the arguments in the delay cases has been that the parties had not anticipated the delay but in the 1922 case of *A.M. Peebles & Son v Becker & Co.*⁹⁹⁷ the parties had inserted a suspension clause into the contract. The contract was generally for the delivery of wood pulp and the suspension clause allowed for the suspension of the contract until the war was over. In this case the contract would have been delayed for four years. The court held that in light of the increase in price⁹⁹⁸ and the delay of four years the parties must have intended to qualify their suspension clause that should the delay be of four years or more both parties would be released from their obligations.⁹⁹⁹ Despite the fact that the rise in value was not the deciding factor in this case the judge used the rise in price (combined with the delay) to evidence the supposed intention of the parties on entering the contract.

Similarly, in the Court of Appeal case of *Express Newspapers Plc v Silverstone Circuits*¹⁰⁰⁰ it was held that a newspaper that had contracted the exclusive right to

⁹⁹⁷ *AM Peebles & Son v Becker & Co* [1922] 10 Ll L Rep 773 (KB).

⁹⁹⁸ *Ibid.* at 774: 'It will be seen that the difficulty of meeting the requirements of users of wood pulp in this country, due to the war, was measured by a rise in price which, though it had fallen greatly from its highest, was still in 1919 three times what it had been in 1914.'

⁹⁹⁹ *Ibid.*: 'It is true that they had bound themselves for a long period of time, subject to the suspension clause: but I still think they would have said: 'If the war is so prolonged as to cause a suspension of the contract until September, 1919, the results on our respective businesses may be so serious that it would be most unwise for either of us to bind ourselves to resume the obligations and liabilities of the contract.'

¹⁰⁰⁰ *Express Newspapers Plc v Silverstone Circuits* The Times, June 20, 1989.

advertise on a bridge did not provide the newspaper with a right to prevent the removal of the bridge. The court therefore implied a term that the licence would terminate if the bridge had to be removed.

6.10 Temporary and Partial Impossibility in English Law

There is a further category of cases that deserves special mention. In cases of temporary and partial impossibility the courts have taken quite a unique approach.

In *Minnevitich v Café de Paris*¹⁰⁰¹ the defendant had contracted for the claimant to play a humorous and light-hearted play over several nights. The contract was based on a payment for each show that took place.¹⁰⁰² Due to the news that the condition of his Majesty King George V was serious the defendant cancelled and the king's death shortly after meant that the shows were cancelled for that week.

Macnaghten J. held that the defendant was justified in cancelling the shows on Monday and Tuesday but that he was not justified in cancelling the shows for the rest of the week. Macnaghten J. concluded that the performance on Monday and Tuesday was impossible but ordered costs for the claimant for Wednesday to Saturday night.¹⁰⁰³ Rather therefore than looking to the doctrine of frustration Macnaghten J. implied a term into the contract that the defendant was under an obligation to allow the claimant to play at his establishment and consequently pay for the performances but it would seem that he also implied a term that in the cases of a particular performance becoming impossible it would not frustrate the

¹⁰⁰¹ *Minnevitich v Cafe de Paris (Londres) Limited* [1936] 1 All ER 884.

¹⁰⁰² To which the court implied a duty on the defendant to allow the claimant to play.

¹⁰⁰³ *Minnevitich v Cafe de Paris (Londres) Limited* [1936] 1 All ER 884, at 886.

obligation to allow the claimant to play on the other days. The courts have therefore used construction in order to find a solution in cases where the contract was only temporarily impossible. With frustration only allowing for the whole contract to be frustrated it seemed that the court was willing to use construction in order to allow the rest of the contract to continue in existence.

In *Cricklewood*¹⁰⁰⁴ the contract was for the lease of land on which the tenant was to erect shops. Due to the war there were restrictions on building which meant that the shops could not be built during this time. The tenant argued that the contract was frustrated. Lord Russell of Killowen held that the lease was not frustrated and that on the construction of the contract it was clear that rent continued to be due but that the landlord was excused from building the shops until such time as this was permitted again.¹⁰⁰⁵

In some cases the courts have been able to interpret existing clauses to cover event of 'partial frustration'.¹⁰⁰⁶ Where no such clause existed the court has fallen back on the general common law doctrine.¹⁰⁰⁷ In *Howell v Coupland*¹⁰⁰⁸ a contract had been

¹⁰⁰⁴ *Cricklewood Property & Investment Trust Ltd v Leighton's Investment Trust* [1945] AC 221 (HL), at 233.

¹⁰⁰⁵ *Ibid.* at 233: '*It seems to me clear that the intention of the parties was that rent would be payable even though the sites were vacant, and that the landlord was not to be driven to sue for damages for breach of covenant to erect shops. To such an action the war-time restrictions might well afford a defence, but that is a consequence very different and far removed from frustration.*'

¹⁰⁰⁶ *Egham & Staines Electricity Co Ltd v Egham UDC* [1944] 1 All ER 107.

¹⁰⁰⁷ *Chitty on Contracts* (Beale ed, Sweet & Maxwell, 2013), at 23-068.

¹⁰⁰⁸ *Howell v Coupland* [1876] 1 QBD 258 (CA).

made for a set amount of potatoes from a certain piece of land. The crop largely failed and the seller delivered the crop that had grown on the land to the buyer.¹⁰⁰⁹ The court held that the seller only had a duty to deliver what had been actually produced on the land on the basis of *Taylor v Caldwell*.¹⁰¹⁰ In *H R & S Sainsbury Ltd v Street*¹⁰¹¹ the parties had entered into a similar contract and most of the crop failed. The seller then sold the reduced amount of crops at a higher price to a different buyer. The court held that the seller was only liable for the amount that had actually been produced and not for the amount stated in the contract. However, here the decision was based on an implied term rather than on frustration¹⁰¹² and so it could be argued that there is no doctrine of partial frustration in English law.

However, in *The Zuiho Maru*¹⁰¹³ Kerr J. held that there was '*an absolute obligation to supply cargo of the contractual description and quantity*' where the government in Saudi-Arabia had instructed the only oil supplier to cut 10% of the production for a set period. This cut was passed on to the individual tankers and in this particular case 7.52% less oil was loaded. Kerr, J. in his judgment went on to hold that '*[w]ithout resort to any definition of the nature of a frustrating event, it is self-*

¹⁰⁰⁹ He also delivered crop from another piece of land but it seems that was beyond his duty (see Treitel, *Frustration and Force Majeure* (Sweet & Maxwell 2004); para 5-012).

¹⁰¹⁰ *Taylor v Caldwell* [1863] 122 ER 309 (KB).

¹⁰¹¹ *HR&S Sainsbury Ltd v Street* [1972] 1 WLR 834.

¹⁰¹² See also *Cricklewood Property & Investment Trust Ltd v Leighton's Investment Trust* [1945] AC 221 (HL).

¹⁰¹³ *Kawasaki Steel Corp v Sardoil SpA (The Zuiho Maru)* [1977] 2 Lloyd's Rep 552 (CC), 555.

*evident that any short-fall of this kind could never be capable of giving rise to frustration, because there is nothing like a sufficiently fundamental change of circumstances’.*¹⁰¹⁴ It would seem therefore that not any failure of the source will suffice but that it has to be substantial.

6.11 Cardinal Change in English Law

It would seem that cases where for example there has been inflation will not be adjusted. This is suggested by *Davis Contractors Ltd v Fareham UD*,¹⁰¹⁵ where the reasoning was based on the fact that the parties could have inserted a clause safeguarding against the circumstances.

Nevertheless, there have been some specialist areas where an alternative approach has been accepted. In building contracts the doctrine of ‘cardinal change’¹⁰¹⁶ will allow the contract to be ‘adjusted’¹⁰¹⁷ in order to take into account the changed circumstances and to therefore adjust the price. The principle, in English law, is that there may be an implied limit on the amount of additional work the contractor is expected to do within the contract rates. The idea is that generally building contracts will allow for certain changes to be made within the limits of the contract

¹⁰¹⁴ Ibid.

¹⁰¹⁵ *Davis Contractors v Fareham Urban DC* [1956] AC 969.

¹⁰¹⁶ It should be noted that the doctrine originated in the US. The English approach to the same principle is achieved by implying a term into the contract which has the same effect (see *Chitty on Contracts* (Beale ed, Sweet & Maxwell, 2013), at 37-096).

¹⁰¹⁷ It should be noted that the word adjusted is being used flexibly here. The court may not necessarily adjust the contract itself but may add a further agreement in order to achieve the same result as adjusting the contract would.

price. If however this limit is exceeded there is an implied term that any excess work will be paid for additionally.¹⁰¹⁸ In *Lindsay Parkinson & Co. & Commissioners of Works*¹⁰¹⁹ a building contract for a factory was made that included a clause by which the commissioner had the absolute discretion to modify the extent and character of the work. Delay was caused through the act of the commissioner which meant that the contractor would have been entitled to an extension. A deed of variation was created which meant that exceptional measures were used in order to speed up the work. This meant that the cost of the work increased significantly and the additions and variations far exceeded what the contractor had expected. The Court of Appeal held that the literal application of the clauses was insufficient. Lord Singleton accepted that it did not appear *‘that anyone thought at the time of the deed of variation that there was any likelihood of anything like the additions which were called for later.’* He therefore held that the clause would have meant that the contractors would have been liable for years and years to come and that this would have led to *‘manifest absurdity and injustice’*.¹⁰²⁰ It was therefore held that the additional work fell outside the contract and had to be paid for on top of the contract price. According to Lord Asquith: *‘In other words delay though literally describing what has occurred, has been read as limited to normal, moderate delay,*

¹⁰¹⁸ *Lindsay Parkinson & Co. v Commissioners of Works* [1949] 2 KB 632.

¹⁰¹⁹ *Ibid.* at 665.

¹⁰²⁰ *Ibid.* at 673.

*and as not extending to an interruption so differing in degree and magnitude from anything which could have been contemplated as to differ from it in kind.'*¹⁰²¹

There are some instances in English law where it may seem as if there has been an adaptation of the contract to the new circumstances. In the building cases, where the work has already been done and the contract is held to be frustrated, the contractor is paid on a quantum meruit basis. In *Bush v Whitehaven Trustees*¹⁰²² the Court of Appeal held even though the contract stated that the contractors were liable for any delays, those delays caused by not having access to the site (due to the other party not allowing them to enter it) were not included. More importantly though after this delay the contractors had completed the contract which the court then held had become a winter rather than a summer building contract (for water mains) and were therefore awarded damages on a quantum meruit basis.¹⁰²³ In *McAlpine Humberoak Ltd v McDermott International Inc.*¹⁰²⁴ a contract to build pallets for the construction of a deck on an offshore oil rig contained provisions that

¹⁰²¹ Or in other words: *Bank Line Ltd v Arthur Capel & Co* [1919] AC 435 (HL) per Lord Sumner: 'A contingency may be provided for, but not in such terms as to show that the provision is meant to be all the provision for it. A contingency may be provided but in such a way as shows that it is provided for only for the purposes of dealing with one of its effects and not all.'

¹⁰²² *Bush v Whitehaven Trustees* [1888] 52 JP 392. Confirmed in *H Fairweather & Co Ltd v Wandsworth LBC* [1987] 39 BLR 106 (QB).

¹⁰²³ Note that Lord Lindley had his doubts as to the decision of the jury. See also Chambers, *Hudson's Building and Engineering Contracts* (12th edn, Sweet & Maxwell 2014), at 4.252 where it is presumed that the case would be decided differently today.

¹⁰²⁴ *McAlpine Humberoak Ltd v McDermott International Inc (No 1)* [1992] 58 BLR 1 (CA).

dealt with how compensation was to be dealt with in cases, including a formula.

The contract was delayed significantly and McAlpine put forward a claim totalling £3.5 million (the contract price was £890,330). The judge at first instance held that due to the fact that the delay had been caused by the defendants (with over 45 revised AFC drawings, failure to respond to queries promptly and changing the scope of the work) and that therefore the contract was frustrated. The Court of Appeal held that the contract had not been frustrated and that as long as the contract included a mechanism for dealing with delay a contract will not be frustrated.¹⁰²⁵ In any event it is difficult to see how the courts were able to refer to frustration since it would seem that there was always a breach by the employer (e.g. it was their fault for not letting the contractor on site) so the contractor may not have been released but the employer would have had to pay damages. This does leave the question unanswered where neither party is at fault and no provisions were made in the contract. It is suggested here that in a case where for example the site is flooded for the summer period and the contract is then performed in the winter which causes an increase in costs, the original contract

¹⁰²⁵ However, the court did hold that due to the delay caused by the defendant the contract could be extended for a reasonable period of time. Once that time had expired the defendant was entitled to damages for the delay.

may be held to be frustrated¹⁰²⁶ and payment would have to be made on a quantum meruit basis, particularly where the contract was performed.¹⁰²⁷

6.12 The English Values

The English section has revealed a slightly different approach to cases of impossibility but first and foremost it revealed a fundamentally different approach (and often outcome) in cases of impracticability. The all-or-nothing approach means that there is very limited scope to adjust the contract (i.e. the cardinal change cases or through construction).¹⁰²⁸ This in itself can already be considered a value but it also provides (in contrast with the German values) that on the scale of things, the English courts seem to be protecting the autonomy of the parties in that they will not bind the parties to a contract that they had not originally agreed. So even in the cases such as *South Staffordshire*¹⁰²⁹ the court preferred to allow the parties to exit the contract and renegotiate than to adjust the contract themselves. Apart from Denning's judgment in *South Staffordshire*¹⁰³⁰ it would seem that the English courts remain committed to the principle of nominalism and there may be good reason. In the German section it was concluded that the protection of the economy was

¹⁰²⁶ Though there are also suggestions that if not regulated by the contract the risk simply lies with the contractor, although the presumption is based on US law (see Lane, 'Disruption and Delay: Fair Entitlement and the Regulation of Risk' (2006) 22 (2) Construction Law Journal 92, at 97) .

¹⁰²⁷ *Lindsay Parkinson & Co. v Commissioners of Works* [1949] 2 KB 632, 665.

¹⁰²⁸ See Ch. 6.11.

¹⁰²⁹ *Staffordshire AHA v South Staffordshire Waterworks Co* [1978] 1 WLR 1387 (CA).

¹⁰³⁰ *Ibid.*

central in the *Opel Case*¹⁰³¹ which is in line with the domestic protection of the market. However, thinking globally, departure from nominalism could have significant repercussions taking into account international trade. There may well therefore be a similar value that the court is protecting, the economy, but that this (also taking into account the fact that the *Opel Case*¹⁰³² was decided around 1920) now means something different in each jurisdiction.

The main stance is that if the parties wanted protection then they should have bargained for it. Though now this may not be absolute it is clear that this will only occur in extreme cases (i.e. frustration)¹⁰³³ and here it seems that the court is only in fact assessing who should bear the risk.¹⁰³⁴

It is submitted here that *South Staffordshire*¹⁰³⁵ is probably so exceptional that it can be side-lined (for now). It is clear that a main value is the principle of nominalism and that subscribing to that principle is seen as protecting the economy (i.e. an alternative understanding to the German value of protection of the economy). It would then mean that the court is first attempting to identify who has taken the risk and in most cases this will mean that frustration cannot apply. In the cases where the court has diverted from the allocation of risk it would seem this

¹⁰³¹ *RGZ 100, 134 (Opel Case)* .

¹⁰³² *Ibid.*

¹⁰³³ See Ch. 6.09.

¹⁰³⁴ *Edwinton Commercial Corp v Tsavliris Russ (Worldwide Salvage & Towage) Ltd (The Sea Angel)* [2007] 2 Lloyd's Rep 517 (CA) at [111].

¹⁰³⁵ *Staffordshire AHA v South Staffordshire Waterworks Co* [1978] 1 WLR 1387 (CA).

has been in order to avoid unjust gain by one of the parties. In cases like *Sainsbury v Street*¹⁰³⁶ the court requires the seller to deliver proportionally in order to ensure that Street cannot gain from the possible increase in market price.¹⁰³⁷ In *Metropolitan Waterboard*¹⁰³⁸ the court identified that it would most likely be significantly more expensive to build after the war. Even in the *Super Servant 2*¹⁰³⁹ the fact that the contract contained the possibility for the owners of the vessel to elect Super Servant 1 or 2 would have meant that they could have unjustly gained by picking the most lucrative contract. The conclusion must therefore be that maintaining the contractual relationships (in contrast to German law)¹⁰⁴⁰ is not a value but that the balance in the English cases is between risk allocation and the prevention of unjust gain. The wider economy is then protected through the uncompromising subscription to the principle of nominalism.¹⁰⁴¹

6.13 Conclusion

The chapter has shown that there are a multitude of values that the courts seem to be protecting, from freedom of contract, party autonomy and nominalism to protection against unjust gain, protection of the economy or preserving the contractual relationship. It is rarely just one value and often it is therefore the degree to which the courts rely on a value or in some cases interpret that value that

¹⁰³⁶ *HR&S Sainsbury Ltd v Street* [1972] 1 WLR 834.

¹⁰³⁷ This approach is in line with ss. 20A and 20B SGA 1979.

¹⁰³⁸ *J Lauritzen AS v Wijmuller BV (The Super Servant Two)* [1990] Lloyd's Rep 1 1 (CA).

¹⁰³⁹ *Metropolitan Water Board v Dick Kerr & Co Ltd* [1918] AC 119 (HL).

¹⁰⁴⁰ See Ch. 6.06.

¹⁰⁴¹ See Ch. 6.09.

is of comparative interest. In the German cases freedom of contract is always the starting point for the courts except that as a principle (or value) this is curtailed by the protection of the parties' will. The parties' will is, and this it seems is not only Savigny's doing but mainly due to the political economic background, that the bargain should retain its equivalence. This means that in the inflation cases the courts could intervene to re-set the prices. Also derived from that same value of protecting the parties' will is the assumption that the parties in most circumstances would have wanted the contractual relationship to continue. This assumption is further justified on the basis of the protection of the economy. By that the German court seems to mean two things: firstly, there is the economic approach which states that only bargains will further the economy and that therefore the contract should be upheld (and adjusted to the new circumstances) but secondly, in terms of the promise that even if the situation changes one party will not simply be released from their contractual obligations but the bargain will still continue. This has the positive side effect that the parties, in changed circumstances, are more likely to re-negotiate the contract before going to court in order to save the expenses.¹⁰⁴²

In the English cases the starting point seems also to be freedom of contract.¹⁰⁴³ In no way competing with the freedom of contract is the value of party autonomy which is interpreted as refraining from intervening in the way the parties have allocated the risk (or the natural risk allocation). In contrast to the German courts where the value of upholding the equivalence of the bargain (to the detriment of

¹⁰⁴² See for example *BGH LM § 242 (Bb) BGB Nr. 12 (Drill Hammer Case)* .

¹⁰⁴³ See Ch. 6.07.

freedom ‘from contract’) is grounded in the hypothetical will of the parties.¹⁰⁴⁴ The non-willing of the parties (i.e. the parties had never thought about the circumstance) that in German cases leads to the assumption that the parties meant the contract to be adjusted leads to the opposite conclusion in the English cases. The justification it would seem in the English cases (with the exception of cases such as *South Staffordshire Waterworks*¹⁰⁴⁵) is the principle of nominalism that has stood firmly as a principle underpinning English contract law.¹⁰⁴⁶ Nominalism and the freedom of contract are then seen as the values that lead to the protection of the economy – quite the opposite to the German conclusion.

One further value that emerges in both the English and the German approach is that of protection against unfair gain. Losses, particularly according to the English approach, seem to be a natural consequence but it is protection against unfair gain with which the courts seem to be concerned. In *Dick Kerr*¹⁰⁴⁷ (temporary impossibility) and *Sainsbury v Street*¹⁰⁴⁸ it seems that the court is protecting against unfair gain by either the party getting something that after the war would have become much more expensive or which due to (probably) general shortage would be more valuable. There may be the temptation to argue that the English approach is really protection against loss rather than gain but it is the look to cases such as

¹⁰⁴⁴ See Ch. 6.06.

¹⁰⁴⁵ *Staffordshire AHA v South Staffordshire Waterworks Co* [1978] 1 WLR 1387 (CA).

¹⁰⁴⁶ See Ch. 6.09 and Ch. 6.10.

¹⁰⁴⁷ *Metropolitan Water Board v Dick Kerr & Co Ltd* [1918] AC 119 (HL).

¹⁰⁴⁸ *HR&S Sainsbury Ltd v Street* [1972] 1 WLR 834.

the *Super Servant 2*¹⁰⁴⁹ that identify that the election by one party (and therefore the taking of risk) is the deciding factor which again is nothing else than the protection against an unfair gain by one party.

Overall, this chapter can conclude that the objective choice of values seems on the face of it to be the same, protection of the economy, freedom of contract but that on closer inspection the labels seem to have very different underlying meanings (and values) attached to them which then lead to different results.

Chapter 7 - Conclusion

The first task of this research project was to provide a comparative analysis of German and English contract law by focussing on problems concerning pre-contractual duties of disclosure, mistake (particularly mistake as to quality), unfair contract terms and impossibility (though it may be more appropriate to say impracticability here). In all four chapters, the emphasis was on identifying cases where the outcome would be different between the two systems and also to identify possible ways in which the problem may be addressed (e.g. in relation to promissory estoppel it was identified that in other common law jurisdictions it is possible to use this device as a sword).¹⁰⁵⁰ This research also examined the underlying values of these concepts in each jurisdiction and identified that the values held by judges and legislators influenced the outcome of the cases (or the structure and content of the legislation). In most cases, the values were clearly

¹⁰⁴⁹ *J Lauritzen AS v Wijmuller BV (The Super Servant Two)* [1990] Lloyd's Rep 1 1 (CA).

¹⁰⁵⁰ See Ch. 3.07 – Ch. 3.11.

articulated by the judges or legislators (e.g. freedom of contract was often used as a foundational argument in most chapters).¹⁰⁵¹ In cases where there was no articulation of the values, this thesis identifies the values that most likely underlie the decision.¹⁰⁵²

The judges and legislators have been willing to articulate and discuss the underlying values in both the German and the English system to a similar extent. However, a surprising conclusion of this research is the lack of academic discussion of these values in the German literature.¹⁰⁵³ The introduction found that there has been some discussion of values in English literature on English law;¹⁰⁵⁴ this conclusion will aim to contextualise and situate the findings of this thesis into the macro analysis of values conducted by Adams and Brownsword,¹⁰⁵⁵ yet there appears to be little on the values of German law in German academic literature. This does not mean that the values have been absent in German law just that they have not been adequately discussed; this thesis seeks to fill the gap around German values.

¹⁰⁵¹ E.g. Ch. 3.02.

¹⁰⁵² E.g. Ch. 5.05.

¹⁰⁵³ See Ch. 2.02 for the relevant literature.

¹⁰⁵⁴ See Ch. 1.03.

¹⁰⁵⁵ Adams and Brownsword, 'The ideologies of contract' (1987) 7 Legal Studies 205.

7.01 The values

The values that have been identified in this thesis are protection of the will of the parties,¹⁰⁵⁶ protection of party autonomy¹⁰⁵⁷, invested trust (either in the other party or in the venture),¹⁰⁵⁸ *pacta sunt servanda* (i.e. the contract is binding),¹⁰⁵⁹ equivalence and also nominalism,¹⁰⁶⁰ *clausula rebus sic stantibus* (i.e. the assumption that circumstances will remain the same),¹⁰⁶¹ protection of society,¹⁰⁶² protection against unfair gain,¹⁰⁶³ risk allocation (whether contractual or by the legislator),¹⁰⁶⁴ protection against informational imbalance,¹⁰⁶⁵ protection of the legislative body,¹⁰⁶⁶ protection of the parties' contractual relationship,¹⁰⁶⁷ and the reasonable expectations of honest men.¹⁰⁶⁸

¹⁰⁵⁶ Particularly in Ch. 4. 03.

¹⁰⁵⁷ Here there are several meanings attached for example this could go to the parties consent but also could be framed in the German terms of self-determination.

¹⁰⁵⁸ E.g. Ch. 4.08.

¹⁰⁵⁹ This is often the starting point of the discussion. See for example Ch. 4.01.

¹⁰⁶⁰ E.g. 6.04 and Ch. 6.07.

¹⁰⁶¹ Ch. 6.04.

¹⁰⁶² Suffice it to say here that there are several meanings that could be attached to this value. See for example Ch. 5.05.

¹⁰⁶³ E.g. Ch. 6.13.

¹⁰⁶⁴ E.g. Ch. 5.13.

¹⁰⁶⁵ E.g. Ch. 4.07.

¹⁰⁶⁶ E.g. Ch. 3.02.

¹⁰⁶⁷ E.g. Ch. 6.06.

¹⁰⁶⁸ E.g. Ch. 5.09.

In addition to identifying these values the thesis also reveals that both jurisdictions rely on almost all these values, but not in equal measure. This means that even though it is important to identify the values involved in each of the individual problems it seems to be the difference in weight that the judges attach to each value that dictates the outcome of the case. The weight that is given to each value can often be explained through an analysis of the socio-historic background. This is done by retracing a value back to its origin, taking into account the influences and developments the values have undergone. A prime example of this is the value of 'equivalence'. The influence of inflation on post-war Germany meant that the courts were willing to depart from the competing value of nominalism in favour of equivalence in order to protect the German social order (or economy). 'Clausula rebus sic stantibus' was therefore seen as a measure of protecting the balance of the contract. The idea of equivalence appears briefly in the English case of *South Staffordshire Waterworks*,¹⁰⁶⁹ but overall the value of nominalism overrides equivalence.

Finding the original source of the value helps to explain why a given value exists in the modern context, as well as helping to establish the limitations of values in the context of other competing values. The conclusion that must be drawn, therefore, is not that the underlying values in German and English law differ, but the weight that is given to each value differs, which in turn may lead to a different result.

¹⁰⁶⁹ *Staffordshire AHA v South Staffordshire Waterworks Co* [1978] 1 WLR 1387 (CA).

7.02 Values and their context

Chapter three compared the approach of the two jurisdictions to pre-contractual duties of disclosure. The starting point in both systems is the freedom of contract¹⁰⁷⁰ which translates into the general understanding that the parties are not liable to each other until they have entered into a contract. In other words, the parties have a choice as to whether or not to enter into a binding contract.

However, the value of 'freedom of contract' is limited (in both systems) in two ways. The first is 'unfair gain',¹⁰⁷¹ where both systems hold that there cannot be gain to the party breaking off the negotiations. The second is where the innocent party has been deliberately (or carelessly) misled.¹⁰⁷² This second limitation finds its reasoning in two different values in each systems. In Germany, it is based on breach of trust that the innocent party has invested in the other party. In England, it relates to dishonesty or carelessness of the party that has misled. The third limitation on the parties' freedom of contract is based on blameworthy behaviour (this is where culpa in contrahendo comes in). However, the understanding of what constitutes blameworthy behaviour (or where there is a duty of care) is wider in Germany than in England.¹⁰⁷³

One of the limitations on blameworthy behaviour in the German cases is the need to protect the BGB from being circumvented. This was the limitation in the cases

¹⁰⁷⁰ See Ch. 3.02 and Ch. 3.07.

¹⁰⁷¹ See Ch. 3.04.

¹⁰⁷² See Ch. 3.06.

¹⁰⁷³ See Ch. 3.06.

where the BGB requires a need for formality.¹⁰⁷⁴ This means that the protection of the BGB aids the freedom of contract but is itself limited by the fact that the innocent party must also be protected from the misuse of the BGB (as discussed in greater detail in subsequent chapters of this thesis). Chapter three demonstrated how the underlying values can lead to a different understanding of fault and of what 'deliberately misleading' means. In sum, means 'freedom of (or from) contract' competes with 'protection against unfair gain'. Liability for blameworthy behaviour competes with freedom of contract and in Germany the balance falls in favour of the liability (based on the parties' will).

The balance of the values in chapter four led to a difference in outcome. Where A has given B to understand that there will be a contract, A will be liable in reliance loss. In the English cases there has to have been a positive statement by A (and this is also only supported by one case).¹⁰⁷⁵ The conclusion of chapter three suggests that the difference in understanding of what 'blameworthy' is (resulting from the different balance of values) means that there is a narrower duty of care in the English cases as opposed to the German ones.

Chapter four continues to discuss most of the values found in chapter three, but also identified new values which compete with each other and the values already identified. The law of mistake in Germany relied on the will-theory, while the English approach is based on reasonable reliance. The approach in Germany means that the 'will of the party' and 'party autonomy' align, although they compete with

¹⁰⁷⁴ See Ch. 3.10.

¹⁰⁷⁵ *William Reginald Box v Midland Bank Ltd* [1981] 1 Lloyd's Rep 434 (CA).

'pacta sunt servanda'. They are also limited by protecting the non-mistaken party against loss (through § 122 BGB – underpinned by the value of 'reasonable reliance') – though this may also be limited if there is fault. Most importantly, though, 'pacta sunt servanda' is limited by the protection against informational imbalance and the protection of society against unbearable results (e.g. disproportionate sanction. Furthermore, due to the proximity of the law of mistake and the pre-contractual duties of disclosure, pacta sunt servanda can also be limited by the duty of disclosure, underpinned by the protection of invested trust. In English law the starting point is the objective theory of assent and pacta sunt servanda. This only applies in England with contracts of a certain type (e.g. joint venture) or in very limited categories of special relationship (e.g. solicitor and client). Overall, the chapter reveals a strong reliance in the German law on social elements which only appear in the English cases where they have become part of the contract. Invested trust, protection of society and the will-theory feature a lot lower in English law than in German law in these cases.

Chapter five compares the law on unfair contract terms. The starting point in both jurisdictions is pacta sunt servanda. However, in Germany the protection of society is a strong underlying value. As part of that value the court considers limitations of pacta sunt servanda necessary in order to protect the order of the BGB. It means that the value that previously aligned with pacta sunt servanda, namely the protection of the values of the BGB, opposes it in these circumstances. Protection of society in the German context seems to be divided between terms that are unfair to the other person (something we see in English law too) but then also the terms that are unfair to society (e.g. to competitors). This means that on the one hand the

court is protecting the other party and competitors but it is also protecting the rules (or norms) of society.

Furthermore German law considers the will of the parties limited through unfair standard terms which then creates a duty to take into account the other party's will. In Germany then there are three things that are protected. Firstly, The English limitations on *pacta sunt servanda* are here the will of the party, in the sense of consent and more importantly the question of risk allocation (or to what extent the usual allocation had been altered by the standard terms). However, the English context is much more limited in that it does not deal with standard term contracts generally but only with exclusion clauses and business to business contracts.

Although the English courts look to societal norms for guidance, it is much less important than in the German cases mainly because the BGB states *prima facie* that any departure from the norms is unreasonable, whereas the English courts are much more willing to allow the parties to fashion their own terms. The argument here then is that the perspective from which the 'agreement' is viewed is different. In Germany the legislation relating to the contractual agreement is seen as coming from higher norms (or 'proper behaviour') and departure from that is seen as a negative. In the English cases the Sale of Goods Act is seen as based on agreement which in turn makes it easier to depart from those rules.¹⁰⁷⁶

Chapter six highlights a particularly interesting difference with regard to what protection of the economy means. The German approach indicates that *pacta sunt*

¹⁰⁷⁶ See Ch. 5.13 and Ch. 5.14.

servanda can be limited by the need to protect society by relying on values such as 'clausula rebus sic stantibus' and 'equivalence'. The English approach means that pacta sunt servanda is strengthened by reference to nominalism and risk allocation. It seems that although the values differ, in the context of impossibility both systems believe to be working towards the same aim, namely protection of the economy. However, 'pacta sunt servanda' has to compete with the prevention of unjust gain. The main difference, though, is that the German courts consider the continuation of the contractual relationship to be a value (i.e. the contract can be adapted). This value does not appear in the English context. It would seem in chapter six that protection of the economy in German law requires protection against undue loss. English law seems to rely on the approach of 'survival of the fittest'.

7.03 Consumer-welfarism or Market-Individualism

The categorisation of consumer-welfarism or market-individualism was championed by Adams and Brownsword in 1987.¹⁰⁷⁷ They describe the approaches as based on 'ideologies', leaving behind any pre-conceptions one might have about the word. In this thesis the terminology values was chosen as the micro analysis of the influences that underlie the judgments. It is in this section that the balance of the values as a whole (rather than categorised by area of law) is used to establish whether the German or English system leans more toward a consumer-welfarist or a market-individualist ideology.

¹⁰⁷⁷ Adams and Brownsword, 'The ideologies of contract' (1987) 7 Legal Studies 205

The basic approach in market-individualism begins with the market and the ideology is to facilitate competitive exchange.¹⁰⁷⁸ This relies on values such as the objective approach to intention and rejection of a subjective approach to mistake. It therefore relies on the security of transaction and the transparency of the outcome. The individualist element of the ideology is based on doctrines of freedom of contract and sanctity of contract.¹⁰⁷⁹ Part of the freedom of contract is, according to Adams and Brownsword, the need to strike down monopolies.¹⁰⁸⁰ Consumer-Welfarism is based on the principle of consistency (i.e. parties should not go back on their promises),¹⁰⁸¹ the principle of proportionality (remedies should be proportionate to the breach that has occurred),¹⁰⁸² the principle of bad faith, the principle that no person should profit from his own wrong, the principle of unjust enrichment, the better loss-bearer principle, the principle of exploitation, the principle of a fair deal, the informational advantage principle, the principle of responsibility for fault and the paternalistic principle.

There are advantages and disadvantages to both methods and these are set by Adams and Brownsword¹⁰⁸³ and in their article the main aim is to establish which category a judges' motive falls into. However, the question here will be to establish whether, in the grand scheme of things, a trend can be established that will allow

¹⁰⁷⁸ Ibid, 206.

¹⁰⁷⁹ Ibid, 208.

¹⁰⁸⁰ Ibid, 208.

¹⁰⁸¹ Ibid, 210.

¹⁰⁸² Ibid, 210.

¹⁰⁸³ Ibid, 213.

for a definite answer of whether German or English law is more consumer-welfarist or market-individualist. The summary of the chapters above confirms that the starting point in almost all areas is freedom of contract and sanctity of contract. From there the judges and legislators move to narrow or limit the scope. The question answered is therefore which jurisdiction ventures further into the consumer-welfarist approach than the other.

To answer this question, as discussed in chapter 3, the element of difference is that in England only an express promise will suffice, whereas in the German system leading a party to believe that a contract will be formed is sufficient to make the party liable. This seems to go the extra step in terms of the principle of consistency in the consumer-welfarist approach. Chapter 4 on mistake provides a difference from the beginning. The German approach of looking at the subjective intention of the parties to ascertain whether there has been a mistake shows consumer-welfarist tendencies. However, the most recent changes indicate that this approach is softened significantly by a stronger reliance on the objective interpretation. Nevertheless, the reliance on the 'invested trust in a relationship' approach that was shown in the *Daktari Film Case*¹⁰⁸⁴ proves that the German approach, again relying on the idea of consistency, pushes the German system closer towards the consumer-welfarist approach than the English case.

Chapters 5 and 6 exhibit a similar trend in that the German courts expect a minimum level of reasonable behaviour towards the other party (or in some cases

¹⁰⁸⁴ BGH MDR 1979, 730 (*Daktari Film Case*).

society, competitors or the other party to the transaction) which is simply not evidenced in the English cases.

The conclusion that must be drawn from this investigation is that German law exhibits more tendencies towards a consumer-welfarist approach where the English system does not move quite as far away from the market-individualist approach.

The overall assessment of which system strikes the correct balance will be left to the reader to decide and open up new directions of research in comparative contract law.

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